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Allan Bulman
Chief Executive
Takeovers Panel
530 Collins Street
MELBOURNE VIC 3000

20 February 2023
By Email

Dear Allan

Consultation paper – GN7 – deal protection

I am supportive of the approach the Panel is proposing in the draft guidance note released last December.

However, I have a few comments for your consideration.

Paragraph 43 - Hard exclusivity

Hard exclusivity is less likely to be problematic if the potential rival bidders are strategic buyers, rather than financial sponsors. Strategic buyers will typically have distinct valuation parameters for a target company and plenty of time to compete and bring forward a proposal in the time leading up to the takeover bid closing or a vote on a scheme of arrangement. I don't think hard exclusivity is so problematic in that instance. I would tone this part down to recognise that.

Paragraph 46(e) – break fees

Contrary to what this paragraph suggests, it does not strike me as reasonable (or common) that a break fee would or should be paid if the major asset of the target is destroyed. In my experience, a break fee would not be payable if there is a "material adverse change" affecting the company, unless the target has caused it. I would delete this subparagraph or at least the words in brackets, and I would replace them with a footnote saying that a break fee paid simply because there is a material adverse change is unlikely to be reasonable.

Paragraph 47 – break fee factors

I do not think these factors are particularly relevant where the break fee meets the 1% guideline. In my experience, a 1% break fee is frequently agreed even if the process has been conducted confidentially. I think you should revisit paragraph 47.

Paragraph 53 - Disclosure

The draft says that, where the relevant arrangements include a notification obligation, the Panel expects disclosure of the material terms of deal protection arrangements. I am not sure this is correct. Disclosure should not be required, unless the identity of the subsequent bidder must be disclosed to the first bidder. I think the guidance note should draw that distinction.

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I would be very happy to speak to you further about any of these points.

Kind regards

Yours sincerely

Rodd

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27 FEBRUARY 2023

Submission – Guidance Note 7 – Deal protection

We refer to the consultation paper entitled "*Guidance Note 7 – Deal protection*" dated 14 December 2022 ("**Paper**"). We are pleased to provide the following submissions and commentary on the matters raised in the Paper.

1 Summary

The revised Guidance Note is a helpful update.

Our specific points reflect the importance of allowing parties, and in particular target boards, the flexibility to act in a way that reflects the circumstances they are managing. This is particularly important in relation to non-binding proposals where the circumstances will vary materially.

2 Questions

1 **Do you agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals? Please explain.**

We agree that the general principles should apply in both instances.

However, the circumstances in which non-binding proposals are considered by boards will vary materially. And are likely to vary more than the circumstances of binding proposals. The complexity and dynamic nature of the target board's role in their consideration of a non-binding proposal is noted in paragraph 39 of the draft Guidance Note.

The relevance of individual circumstances is appropriately reflected in paragraphs 43 to 45. However, we think that there should be more flexibility around the 4 weeks limit for hard exclusivity (see the answer to question 4).

2 **Are the general principles and factors that the Panel will have regard to in considering whether deal protection devices give rise to unacceptable circumstances useful (see paragraphs 8 to 16)? Do you agree with the approach set out? Please explain.**

Yes.

3 **Is the guidance on an effective 'fiduciary out' useful (see paragraphs 35 to 38)? Please explain.**

Yes.

4 Do you agree with the Panel's approach to 'hard' exclusivity arrangements agreed in respect of non-binding proposals? Do you consider that a short period of 'hard' exclusivity is not unacceptable in certain limited circumstances (and do you have any comments on the example circumstances described in paragraph 43)? If yes, is the proposed acceptable 'hard' exclusivity period of up to 4 weeks in which exclusive access to non-public due diligence is provided appropriate? Please explain.

We believe an appropriate period of hard exclusivity should be allowed, and we think the Panel's guidance in paragraphs 43 and 45 will assist market participants. However, we believe that the reference to 4 weeks in paragraph 44 should be a guide rather than a limit. The appropriate length of time should depend on the particular circumstances and a fixed quantitative approach is inconsistent with that principle.

For example, the final sentence of paragraph 44 could be amended to read: "… *is provided would be short and limited (and any no-talk would be consistent with this period*" with footnote 32 reading: "*As a general guide, a period of up to 4 weeks hard exclusivity (including any extensions of time) may not be unacceptable. But a shorter or slightly longer period may be more appropriate. It will depend on all the circumstances.*"

This guiding approach better aligns with the illustrative examples provided in paragraph 45, which emphasises the fact-sensitive and circumstance-specific nature of pre-deal exclusivity arrangements.

As noted above, the actual period of hard exclusivity should depend on all of the circumstances. This would include those set out in paragraph 43, as the Panel will look at the circumstances as a whole and the context in which the arrangement was entered into in considering whether or not a hard exclusivity arrangement is unacceptable. As well as the factors set out in paragraph 43, there may be other factors such as whether the data room has been established and the amount of due diligence that needs to occur. A data room may take two weeks to establish and site visits and other considerations may necessitate an incrementally longer period than four weeks having regard to all the relevant circumstances.

5 Do you agree with the Panel's position on break fees in respect of non-binding proposals (see paragraph 49)? Please explain.

No.

We think that the position on break fees for non-binding proposals should better reflect the fact that circumstances will vary. And not state that that the Panel does not expect the target board would agree to a break fee.

Paragraph 49 should reflect the fact that there will be a particular onus on a target board when agreeing to a break fee for a non-binding proposal given the lack of binding proposal; and that in agreeing to pay a break fee (in the non-binding proposal context), target directors must be prepared to justify the basis for that agreement and to establish that appropriate negotiation took place before agreement was reached.

We also do not think that the quantum would necessarily be substantially lower. Costs for a potential bidder may be material and the benefit to shareholders of the target of a bid may be substantial. The reality is that the costs of bidders in both binding and non-binding proposals can be more than the cap of 1%.

6 Do you agree that the deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal

(see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain.**

We do not believe that there should be a policy that all deal protection arrangements should be disclosed where a notification obligation has been agreed. A notification provision is simply one element of an exclusivity package. As noted in GN7, "*a target board is required to have regard to and balance all of the relevant circumstances. (paragraph 8)* And a target board needs to be free to agree to an arrangement that secures a better proposal for shareholders.

However, we do believe that when assessing an exclusivity package, the inclusion of a notification provision is an element that has the potential to be more likely than other elements of a customary exclusivity package to reduce a meaningful competition for control. And that for this reason, a target board will have a particular need to justify the inclusion of a notification provision.

If the Panel does decide that there should be compulsory disclosure of any notification provision, we have considered whether it would be enough for the target to disclose something such as "there are also other appropriate exclusivity arrangements" or "there are customary exclusivity arrangements". However, this is likely to lead to uncertainty and an uninformed market.

At the same time that this Guidance Note is revised, ASX should update the operation of Listing Rule 3.1A (or Guidance Note 8 in relation to it). In particular, footnote 156 of Guidance Note 8 states that exclusivity agreements are not expected to be disclosed. With the possible effect of this existing guidance in mind, the Panel could consider giving additional guidance in its Guidance Note about the extent of disclosure that would be required where the Panel decides that disclosure of notification obligations is required; perhaps by exception.

7 **Do you agree with the other amendments made to the Guidance Note? Please identify any other amendments you think should be made.**

Yes:

- Footnote 12 should cross-reference the new Guidance Note 19 on the issue of provision to rival bidders, and we think a proviso relating to rival bidder information provision where insider participation exists would also be appropriate.
- Paragraph 33: We think that the duration of a matching right should be no more than 3 (rather than 5) business days.

Yours sincerely

Signed Will Heath

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Takeovers Panel Guidance Note 7 Consultation Process – Submissions

1 Do you agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals? Please explain?

1.1 Yes, we agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals. Particularly in circumstances where a target agreed to provide the initial potential bidder with certain deal protection mechanisms, eg exclusivity arrangements and such mechanisms are not announced, potentially affecting the market for control of that target.

1.2 Notwithstanding our submission in paragraph 1, there may be a greater emphasis on ensuring anti-competitive effects during the non-binding phase as there has not yet been the quid pro quo of a binding transaction agreed to justify the diminution of the market for control of the target by virtue of any agreed exclusivity provisions. Indeed, a clear distinction should be drawn between binding and non-binding proposals through-out paragraphs 40 to 46 through the express use of "potential bidder/acquirer" and "non-binding proposal".

2 Are the general principles and factors that the Panel will have regards to in considering whether deal protection devices give rise to unacceptable circumstances useful (see paragraphs 8 to 16)? Do you agree with the approach set out? Please explain.

2.1 We agree with the proposed approach to the general principles and factors set out in paragraphs 8 to 16. Particularly, the reframing of the general principles to start with the role of the target board during the M&A process is useful as it provides target directors with the necessary guidance to enable the target directors to reject certain deal protection mechanisms that may reduce the competition for control.

2.2 The general principles should also be guided by the abundance of jurisprudence and Panel decisions that have informed the structuring of exclusivity regimes and 'effective fiduciary outs' to date.

3 Is the guidance on an effective 'fiduciary out' useful (see paragraphs 35 to 38)? Please explain.

3.1 Yes, inclusion of what is an effective 'fiduciary out' is useful. However, following the *Virtus Health*[1] matters it appears that market practice has continued to draft fiduciary out clauses for non-binding proposals in accordance with the Panel's decision in *Ross Human Directions*[2].

3.2 With the increasing use of pre-binding phase exclusivity regimes, there is a risk arising by virtue of the need for a target board to conclude that a non-binding indicative offer is reasonably capable of being implemented and delivering a superior outcome for target shareholders, particularly where that non-binding indicative offer is subject to due diligence and/or certain pricing assumptions. It would

[1] *Virtus Health Limited* [2022] ATP 5; *Virtus Health Limited 02* [2022] ATP 7; *Virtus Health Limited 05* [2022] ATP 15; *Virtus Health Limited 06R* [2022] 17.

[2] *Ross Human Directions Ltd* [2010] ATP 8.

be useful if the Panel could provide further guidance following the *Virtus* decision that clarifies that fiduciary out clauses in non-binding proposal circumstances should leave it to the discretion of the target directors as to whether a competing proposal is a superior proposal in accordance with their directors' duties, without prescribing what factors are essential for a competing proposal to be a superior proposal. We note for completeness the same issue does not necessarily arise with regards to the operation of a matching right regime as the trigger for such regime is predicated on their being a binding implementation agreement available in respect to the superior competing proposal.

3.3 It would also be useful if the Panel could provide further guidance regarding the operation of effective fiduciary out clauses in respect of whether a target board, that is relying on a fiduciary out clause, can continue to engage with a competing potential bidder even if the initial potential bidder has provided a subsequent proposal. In our view, a 'market standard' fiduciary out clause would only be effective prior to any subsequent proposal being provided by the initial potential bidder and the target board would therefore only be able to engage with the competing potential bidder until such time that the subsequent proposal is received.

4 Do you agree with the Panel's approach to 'hard' exclusivity arrangements agreed in respect of non-binding proposals? Do you consider that a short period of 'hard' exclusivity is not unacceptable in certain limited circumstances (and do you have any comments on the example circumstances described in paragraph 43)? If yes, is the proposed acceptable 'hard' exclusivity period of up to 4 weeks in which exclusive access to non-public due diligence is provided appropriate? Please explain.

4.1 We agree with the Panel's position in paragraph 41 that 'hard exclusivity' is likely to have an anti-competitive effect and will therefore likely give rise to unacceptable circumstances, other than in limited circumstances.

4.2 We consider that a period of 4 weeks during which exclusive access to non-public due diligence is provided is excessive and will likely have a significant anti-competitive impact on the market for control of the relevant target company. It is not necessary for the hard exclusivity period to be sufficient to cover a period to complete due diligence. It is a sufficient advantage to keep competing potential bidders out of the process for a period of time to provide the beneficiary of hard exclusivity a 'head start' over competing potential bidders.

4.3 We would consider a 1 to 2 week period to be more appropriate for the specific examples listed in paragraph 43, particularly since the examples provided in the Guidance Note contemplate an existing due diligence program.

4.4 We are aware of commentators who hold the view that any hard exclusivity period should not commence until due diligence access has been fully provided. If that position is adopted, this will effectively permit the extension of the Panel guidance of a maximum hard exclusivity period of 4 weeks by the time it takes a target to open a data room. We do not think that should be acceptable and will be prone to abuse, particularly in circumstances where competing potential bidders do not know that hard exclusivity has been granted or when the hard exclusivity period will end.

4.5 Further, given the fiduciary out regime is principally governed by case law in Australia, consideration of the proposal to permit hard exclusivity should be considered in this context to ensure that the Panel's position will not be inconsistent with any existing legal precedent.

5 Do you agree with the Panel's position on break fees in respect of non-binding proposals (see paragraph 49)? Please explain.

5.1 Yes, we agree that break fees should only be generally payable in circumstances where a binding deal has been entered into between the parties, other than in limited circumstances.

5.2 In the non-binding phase, break fees should be the exception and then only to cover actual out-of-pocket expenses.

6 Do you agree that deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal (see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain.

6.1 ASX Guidance Note 8 provides "*an agreement entered into to facilitate a negotiation about a transaction (eg, a confidentiality agreement or an exclusivity agreement), rather than to implement or give effect to a transaction, would not be expected to be disclosed, provided the requirements of Listing Rules 3.1A.2 and 3.1A.3 continue to be satisfied*".

6.2 Notwithstanding the above, we agree with the Panel's approach in respect of requiring disclosure where a notification obligation is agreed. A notification obligation can be distinguished from other mechanisms – 'no shop', 'no-talk' and 'no-due diligence' obligations – which, assuming an effective fiduciary out is applicable (per the Panel's guidance in this Guidance Note), would not unduly affect the market for control of the target if they were not announced by the target.

6.3 The Panel should consider providing guidance in respect of the target's disclosure obligations in circumstances where hard exclusivity or break fees have been agreed in the non-binding phase. We consider that there are at least three possible instances that would warrant public disclosure:

(a) entering into a hard exclusivity period – particularly where entry into such hard exclusivity arrangements effectively shuts down an existing auction process given the need to communicate the cessation of the auction to the other participants;

(b) granting notification rights and/or matching rights to a potential bidder, noting that the operation of these will give rise to a class of persons receiving selective disclosure; and

(c) disclosure required in accordance with the existing continuous disclosure regime in the ASX Listing Rules and *Corporations Act 2001* (Cth), eg loss of confidentiality, where a quantum of a break fee is sufficiently material to trigger disclosure etc.

6.4 The Panel should consult with ASX and ASIC in respect to the proposed continuous disclosure requirements to ensure that such disclosure is regulated consistently.

7 Do you agree with the other amendments made to the Guidance Note? Please identify any other amendments you think should be made.

7.1 Yes, we agree with the other amendments made to the Guidance Note.

7.2 We have no further amendments.

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28 February 2022

Takeovers Panel Consultation Papers
Response to revised Guidance Note 7

Introduction

We welcome the Takeovers Panel's (**Panel**) proposal to revise Guidance Note 7 and appreciate the opportunity to comment on the proposed form of the revised guidance notes.

Revised Guidance Note 7

General

We support the approach the Panel has adopted in revised Guidance Note 7, in particular in respect of 'hard' exclusivity. We believe target boards are best placed to determine when it is in the best interests of a company and its shareholders to agree to deal protection arrangements; but recognise there will be circumstances in which deal protection arrangements unjustifiably reduce meaningful competition for control and should be refused by target boards and not permitted by the Panel. In our view, the revised Guidance Note 7 fairly balances those tensions and provides useful guidance to market participants which is not overly prescriptive and recognises that each situation (in which deal protection arrangements are agreed) is different.

That being the case, we make specific comments on the particular aspects of the revised guidance that we believe should be further considered by the Panel below (and do not confirm and outline why we otherwise agree with the Panel's approach). The consultation paper questions to which these specific comments relate are referenced in the headings.

Specific comments

1 Guidance on an effective 'fiduciary out' (paragraphs 35 to 38) [question 3]

The summary of the *Virtus Health Limited* [2002] ATP 5 case (at paragraph 45) concludes by noting that: *'The Panel was also concerned about the effectiveness of the 'fiduciary out' in circumstances where the original bidder had the prospect to match any counterproposal with a further non-binding proposal'.*

However, in the section where the Panel provides guidance on an effective 'fiduciary out' (paragraphs 35 to 38), including by providing examples of potentially unacceptable fetters and constraints, this concern the Panel had in the Virtus case is not addressed.

We agree with that approach because we take it to mean the Panel does not consider there to be an unacceptable fetter or constraint on a 'fiduciary out' simply because the 'fiduciary out' allows the original bidder to match a counterproposal with a further non-binding proposal, and that the Panel is not suggesting that once the 'fiduciary out' gate is opened, the target directors cannot separately determine that they will not talk further with the rival bidder where they consider doing so is not in the target's interests. If that is not a fair reflection of the Panel's position the guidance should be clarified to make clear how the Panel is likely to approach a fiduciary out that allows the original bidder to match a counterproposal with a further non-binding proposal. That is how a 'fiduciary out' often operates as part of a deal protection arrangement in respect of a non-binding proposal, so it is a matter the market would benefit from clarity from the Panel on.

2 'Hard' exclusivity period (paragraph 44) [question 4]

The Panel's guidance provides that: *'…where hard exclusivity is agreed, it is generally expected that the period in which exclusive access to non-public due diligence is provided would be short and limited to no more than 4 weeks (and any no-talk would be consistent with this period)* (emphasis added).'

We have interpreted this guidance to just relate to the duration of any period of 'hard' exclusivity, rather than any exclusivity restrictions that may apply after the 'hard' exclusivity period ends. On that basis, we agree with the guidance.

However, the underlined words could be interpreted to mean – where there is a period of 'hard' exclusivity – any no-talk and no due diligence restrictions as part of those deal protection arrangement should generally be limited to 4 weeks (even if they become subject to a 'fiduciary out').

We believe the Panel should clarify this wording to ensure the guidance is interpreted as intended. If the intention is what we have interpreted it to be, we would recommend the paragraph be amended to read: *'…where hard exclusivity is agreed, it is generally expected that the period ~~in which exclusive access to non-public due diligence is provided~~ of 'hard exclusivity' would be short and limited to no more than 4 weeks ~~(and any no-talk would be consistent with this period)~~.'*

Limiting this paragraph to the Panel's guidance on the duration of any period of 'hard' exclusivity would not be taken to suggest the Panel has no concerns about the duration of other deal protection arrangements. Market participants should of course heed the comments the Panel has made on the duration of deal protection arrangements generally in previous decisions (including in *AusNet Services Limited 01* [2021] ATP 9).

3 Disclosure of deal protection arrangements agreed in respect of a non-binding proposal (paragraph 53) [question 6]

The revised guidance says the Panel expects deal protection arrangements in respect of a non-binding proposal to be disclosed once they are entered into, *if* they include a notification obligation.

Scope of notification obligation triggering disclosure, and rationale

The rationale offered by the Panel for why it expects disclosure where there is a notification obligation is that: *'a competing bidder should be aware that information in respect of their competing proposal (which may include confidential information) may be disclosed by the target under a notification obligation'*.

That rationale is somewhat limited.

- It would not appear to apply where the notification obligation is limited to the fact of the approach (so no information about the competing proposal is provided under the notification obligation).
- It is diminished as the information required to be provided under the notification obligation is reduced. For instance, does it apply where the consideration proposed is required to be provided under the notification obligation but not the identity of the bidder?
- It would also not appear to apply where on receipt of a competing proposal a target is, under the deal protection arrangements, permitted to inform the competing bidder of the notification obligation and give them the opportunity to withdraw their proposal without the notification obligation applying to it.

We believe there is merit in the Panel clarifying the scope of the notification obligation that attracts this disclosure expectation. For instance, is it intended to apply in the above scenarios?

If the rationale for this disclosure expectation is broader than it is expressed to be above and in the revised guidance, that should be made clear. This disclosure expectation may mean a target is required to make a disclosure it would not otherwise be required to make under the ASX Listing Rules. The potential for the Panel's guidance and ASX Listing Rules to be inconsistent is a reality. However, in our view, that is not a problem, provided the Panel makes out the policy basis for it requiring disclosure where a company's continuous disclosure obligations may not.

Interaction with matching rights and 'fiduciary out'

A matching rights regime ordinarily requires the target to provide the original bidder with the material terms of the competing proposal. The original bidder requires those details to determine whether it will match.

The revised guidance suggests the Panel does not expect a deal protection arrangement in respect of a non-binding proposal to be disclosed if it *does not* include a notification obligation, even if it *does* include matching rights (which contain a requirement to notify the original bidder of the terms of the competing bid). If that is not correct the revised guidance should be clarified.

4 Matching right (paragraphs 32, 33 and 34) [question 7]

We agree with the Panel's guidance that *'[a] matching right cannot be for a duration that removes any practical likelihood that a potential competing bidder will be prepared to put a proposal to the target'.*

However, it is not just the duration of a matching right that can have this effect. In a recent scheme transaction, the implementation deed prevented commercially sensitive information from being provided to a competing bidder if they were a competitor of the target until after the matching rights process had been followed. The only other party that had been identified as approaching the target was another in the same industry as the target and so was considered a competitor as that concept was defined in the implementation deed. That removed any practical likelihood of that interested party, or any other bidder that would be considered a competitor of the target, making a proposal. In our view the Panel should take this opportunity to expand its guidance to address, and we submit warn strongly against, this type of formulation. There are well established ways for protecting commercially sensitive information (including complying with competition law concerns) that are frequently applied during due diligence processes, which do not involve using a matching right to avoid a contest for control that may lead to a superior outcome for shareholders.

5 Other matters [question 7]

The Panel's guidance has not commented on the following 2 matters:

- *Data room access*: Some process deeds require the target to provide the bidder with data room access for a minimum period (say, 6 weeks) even if the non-binding proposal tabled by that 'process deed bidder' does not continue to be the best proposal. Yet rival bidders who then table a superior non-binding proposal are not necessarily afforded the same commitment meaning they may cease to have data room access if they are subsequently outbid by the 'process deed bidder'. While we consider this is somewhat dealt with by the equality of information point in paragraph 16 of the draft guidance, we query whether the Panel should note that undertaking to provide data room access to one bidder for a minimum period but not undertaking to provide similar access to a rival bidder who tables a superior proposal may increase the anti-competitive effect of the original access commitment.

- *Standstills*: Revised Guidance Note 7 is principally concerned with deal protection arrangements that restrain the target. Perhaps for that reason it does not cover standstill arrangements typically contained in confidentiality deeds that restrain potential bidders from acquiring interests in target securities etc during the standstill period. While we agree with the observations in *International All Sports Limited 01R* that the Panel should not be prescriptive about the terms of a standstill arrangement, we query whether the Panel should note an expectation that any standstill arrangements should, as a minimum, contain an exception to allow the standstill party to make a takeover bid for all of the shares in the target during the standstill period following announcement of a control transaction involving or by an unrelated rival bidder.

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J.P.Morgan

28 February 2023

Guidance note 7 – deal protection

JP Morgan submission on consultation paper

We thank the Panel for the opportunity to contribute to the debate on this important topic.

Note these views are general in nature and provided for the purpose of an informed debate on market practices.

If you have any questions on our submission, please contact Kierin Deeming, Managing Director and Head of M&A for Australia and New Zealand on [redacted] in the first instance.

Submissions

1. **Do you agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals? Please explain.**

   We agree the principles should apply in respect of both binding agreements[1] and non-binding proposals for the following reasons:

   - A non-binding proposal is the most common form of initial approach, and is typically seen by the market as the initiation of a potential control transaction
   - The increasing use of "process agreements" blurs the lines between a non-binding proposal and a binding agreement (in that it is binding in some respects but is not a formal binding agreement for implementation of a takeover bid or scheme of arrangement)
   - A Target Board already has significant flexibility in dealing with non-binding proposals (i.e. disclosure) relative to binding agreements
   - This flexibility should not extend to the ability to agree matters that would otherwise be unacceptable if part of a binding agreement, which would otherwise potentially have the effect of reducing contestability at an earlier point in the potential control transaction and entrenching a first-mover advantage.

2. **Are the general principles and factors that the Panel will have regards to in considering whether deal protection devices give rise to unacceptable circumstances useful (see paragraphs 8 to 16)? Do you agree with the approach set out? Please explain.**

[1] As a matter of terminology, we prefer the term "binding agreement" to "binding proposal"

We agree these principles are useful. In particular, we note that they recognise the dynamic nature of a public M&A situation, and the importance of a Board maintaining flexibility to apply its commercial judgement in the best interests of shareholders.

In respect of para 13, we strongly agree that there should not be a requirement to put the company up for auction. In particular, a Board may be cautious in respect of any non-binding proposal to not explore potential alternative acquirors until such time as there is a reasonable prospect of control passing – which means contestability may not eventuate until late in the process (possibly post announcement of a binding agreement). In particular:

- Market expectation of a transaction (e.g. through an auction) can, to some extent, reduce the negotiating leverage of a Target Board
- Failed non-binding proposals can negatively impact the Target through distraction and a market perception of the outcomes of diligence.

3. Is the guidance on an effective 'fiduciary out' useful (see paragraphs 35 to 38)? Please explain.

We are concerned about restrictions on the Target Board in the exercise of its fiduciary duty in relation to competing proposals and agree with the position that the Board should be able to fully exercise its fiduciary duties without unreasonable fetters or constraints.

We agree that the Board is in a better position to understand and make an assessment of all of the relevant facts and circumstances, which includes taking into account factors that may have a degree of subjectivity:

- Consideration mix may not be "like for like" (e.g. listed stock, foreign currency, unlisted scrip, CVRs)
- Funding status, conditionality, timing and executability of a competing proposal may be less certain than the original proposal (and may require co-operation of the Target)
- Proposals that have higher degrees of execution risk (conditionality, complex structures including break-ups, contingent consideration etc.) may still be potentially superior on a risk-adjusted basis

4. Do you agree with the Panel's approach to 'hard' exclusivity arrangements agreed in respect of non-binding proposals? Do you consider that a short period of 'hard' exclusivity is not unacceptable in certain limited circumstances (and do you have any comments on the example circumstances described in paragraph 43)?

We are concerned that the ability to grant 'hard' exclusivity in the conditions in para 43 could lead to this becoming a default market position in those circumstances.

We believe a preferable position would be to not allow 'hard' exclusivity except in very limited circumstances:

In respect of (a) – this is arguably one circumstance where 'hard' exclusivity has a benefit of "levelling the playing field" i.e. where there is a structural impediment to competition through the ownership of the Target.

In respect of (b), if an auction process has been run, the issue of hard exclusivity should largely be moot.

In respect of (c), it is challenging to assess whether the same material price increase could have been obtained in the absence of hard exclusivity. It is also a question of what a material price increase is measured against – an initial low offer could be quickly followed by a material increase coupled with a request for hard exclusivity, enabling a Bidder to change its bidding behaviour to tactically fall within the guidance and justify a 'hard' exclusivity.

In respect of (d), it is challenging to assess if there is ever in fact only a single bidder. In such circumstances, we would query the bidder's need for 'hard' exclusivity if in fact it were the only bidder.

If yes, is the proposed acceptable 'hard' exclusivity period of up to 4 weeks in which exclusive access to non-public due diligence is provided appropriate? Please explain.
If 'hard' exclusivity is to be acceptable in the circumstances in para 43 (noting our comments above), 4 weeks is an appropriate period.

The Panel could consider clarifying that any 'hard' exclusivity period is unlikely to give rise to unacceptable circumstances if it were matched by a go shop obligation of the same duration – which would act as a countervailing pressure on the term of the 'hard' exclusivity.

5. Do you agree with the Panel's position on break fees in respect of non-binding proposals (see paragraph 49)? Please explain.

While we believe break fees in respect of non-binding proposals should remain the exception, we would prefer the Target Board be allowed more discretion in respect of break fees in respect of non-binding proposals:

- Non-binding proposals can vary significantly in terms of comprehensiveness and confidence in a binding agreement resulting and accordingly it is challenging to be prescriptive on the Board's ability to grant a break fee
- A Target Board and shareholders may benefit from flexibility to encourage a non-binding proposal e.g. from a party who may otherwise be unwilling to compete (e.g. due to a synergistic potential competing acquiror; or risks around a major shareholder either competing or blocking)
- We also consider it may be beneficial to clarify how "process agreements" will be treated – which have elements of both binding agreements and non-binding proposals.

Another relevant consideration is the existence of a reverse break fee at the non-binding stage (albeit rare) – if a Target is able to extract a reverse break fee, it may be appropriate to agree a break fee.

6. **Do you agree that deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal (see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain**.

In general, we prefer disclosure to be a consideration for the Board in accordance with the Listing Rules.

In the absence of disclosure of a notification right, a Board may face a decision between:

- Breaching a requirement of confidentiality of the second proposal, which would often contain a provision that if it was to disclosed, the bidder reserves the right to withdraw the proposal (and deprive shareholders of the benefit of a potentially superior proposal)
- Breaching the notification obligation, which may carry contractual claims.

In order to balance these two objectives, the guidance could require any notification obligation that isn't disclosed to have a broad fiduciary out. However, given proposals are typically submitted on a confidential basis we recognise this would in practice potentially negate the impact of a notification provision.

7. **Do you agree with the other amendments made to the Guidance Note? Please identify any other amendments you think should be made**.
We have no comments on other amendments.

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Law Council
OF AUSTRALIA

Business Law Section

Submission in response to Takeovers Panel consultation paper on Guidance Note 7

28 February 2023

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Table of Contents

Introduction

1. On 14 December 2023, the Takeovers Panel (**Takeovers Panel** or **Panel**) published a consultation paper inviting comments on its draft revised 'Guidance Note 7—Deal protection' (**Revised Guidance Note**). This submission has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**) in response to that consultation paper.

2. Unless otherwise stated, all references to paragraph and footnote numbers in this submission are references to the paragraph and footnote numbers used in the Revised Guidance Note.

Responses to specific questions

Question 1

Do you agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals? Please explain.

3. Yes, the basic principle—that deal protection arrangements entered into by the target should not unduly fetter the market for control of the target—should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals. However, different considerations apply at each stage, and there are significant differences between what is acceptable at the binding transaction phase versus what may be acceptable at the non-binding bid phase. For example, at the non-binding bid phase, where the target has received a confidential non-binding indicative proposal subject to due diligence and entry into a binding implementation agreement, the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, while recognising that there may be situations where the target board determines that it is necessary to grant exclusivity with a fiduciary out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal. However, the position is different once the bidder has put forward a binding proposal, which may justify a broader suite of deal protection arrangements (e.g. matching rights; notification obligations and equal access obligations), although any no-talk must be subject to a fiduciary carve-out, particularly where the arrangements will continue for a period of potentially 6 months or more.

4. The Committee considers that the Revised Guidance Note would benefit greatly from some re-drafting to (a) more fully explain the different considerations at the non-binding proposal stage versus the binding transaction phase; and (b) to capture in one place in the Revised Guidance Note the rules that apply during the non-binding proposal stage. At the moment, there is a section on the "Non-binding bid stage" (paragraphs 39–45), which largely deals with hard exclusivity, but the rules relating to other deal protection arrangements in the non-binding proposal stage, such as break fees, notification obligations and matching rights, are found elsewhere throughout the document. To make the Revised Guidance Note easier to read, the Committee suggests that the Revised Guidance Note deal firstly with the rules applying at the

binding transaction phase, and then have a separate section which explains the different considerations, and what the rules are, at the non-binding proposal stage. That separate section could emphasise the point made in the *Virtus* and *AusNet* decisions that the Panel will look at the various deal protection provisions as a whole.

5. In the Committee's view, the Revised Guidance Note also needs to more fully explain the rules that apply at the non-binding proposal phase. For example:

   - As discussed above, the Committee considers that the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, while recognising that there may be situations where the target board determines that it is necessary to grant exclusivity with a fiduciary carve-out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal.

   - On break fees in respect of non-binding proposals, the Revised Guidance Note states (at paragraph 19) that "the Panel does not expect" that a target board would agree to a break fee in respect of a non-binding proposal, but then suggests that a break fee would not be unacceptable if it was "substantially lower", without any indication of what that means. A reference to actual out-of-pocket external adviser costs would be a helpful starting point. The Revised Guidance Note also does not address cost reimbursement arrangements in the non-binding proposal stage, which have been a feature of a number of 'process deeds' entered into over the past few years. There is also the issue, which arose in *Virtus*, whether the break fee/cost reimbursement fee which is payable in circumstances where the target terminates the discussions for a competing proposal should be no higher than the cost reimbursement fee which is payable where the bidder puts a binding proposal at the original indicative price, but the target board decides not to recommend it.

   - On matching rights, there is no real discussion of whether they should apply and, if so, how they should apply, in relation to a non-binding proposal. In the Committee's view, matching rights are not appropriate where the proposals are non-binding and can be withdrawn by the bidder(s) at any time anyway. Matching rights in respect of non-binding proposals can lead to the situation where each of the existing bidders continues to increase its indicative price simply to maintain the exclusivity, in circumstances where it will not ultimately be held to that increased price.[1]

   - On notification obligations, the Revised Guidance Note does not fully differentiate between the situation where the proposal remains confidential versus where it is not; nor does it focus on the nature and extent of the disclosure obligation (i.e. is it an obligation to notify the identity of the competing bidder and the full terms of the proposal, or

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[1] This was an issue in *Re Ludowici Ltd* [2012] ATP3 (see especially at [17]).

simply for the target to notify the first party that the target is no longer dealing with it on an exclusive basis).

- On disclosure, the Revised Guidance Note should reflect the fact that usually there is no obligation under continuous disclosure rules to disclose the arrangements at the non-binding proposal phase, while the deal protection arrangements remain confidential, and because they concern an incomplete proposal or negotiation. However, the Revised Guidance Note could also make it clear that if a 'process deed' has been entered into under which the target board has agreed to recommend the transaction if the bidder puts a binding proposal on the terms of the indicative proposal (or if a material fee would be payable by the target if the target board fails to recommend a binding proposal on the same or better terms than the indicative proposal), then the carve-out to the continuous disclosure rules for an incomplete proposal or negotiation ceases to apply, and the 'process deed' should be disclosed. Some clear guidance on this issue would be welcomed, including on the circumstances in which the Panel considers that a process deed should be disclosed to the market in full.[2]

6. These issues are dealt with further below.

Question 2

Are the general principles and factors that the Panel will have regards to in considering whether deal protection devices give rise to unacceptable circumstances useful (see paragraphs 8 to 16)? Do you agree with the approach set out? Please explain.

7. Yes. The guidance in paragraphs 8–16 is useful, and the Committee generally agrees with the approach set out. However, the Committee has set out below a few specific comments in relation to some of the principles and factors discussed.

(a) **Paragraph 11**

In addition to the factors already listed in paragraph 11, if the target is in financial distress/approaching insolvency, the Panel should also be able to take this fact into account when considering whether a deal protection device gives rise to unacceptable circumstances.

This would be consistent with 'Guidance Note 17—Rights issues', which indicates that the Panel will look at the "financial situation and solvency of the company" when considering whether a rights issue gives rise to unacceptable circumstances.[3]

[2] See *Re GBST Holdings Ltd* [2019] ATP 15 at [43]-[44], where the Panel noted that market practice varied on whether a process deed is released in full or summarised. The Panel noted that it was "an open question in what circumstances it may be sufficient to disclose a summary of a process deed instead of the process deed itself".

[3] Takeovers Panel, 'Guidance Note 17 – Rights issues', Issue 4, 27 June 2018 at [6(a)]. See also [10]-[12], which indicates that a company's need for funds may be relevant to whether a rights issue constitutes unacceptable circumstances.

It would also be consistent with the Panel's decision in *Re Mission NewEnergy Ltd* [2012] ATP 19 and *Re Mission NewEnergy Ltd (No 1R)* [2012] ATP 20, which involved a company with significant financial difficulties entering into a term sheet (which contained an exclusivity regime without a 'fiduciary out') with another party for the provision of a credit facility. In concluding that that there were no reasonable prospects of making a declaration of unacceptable circumstances, the Initial Panel took into account (among other things) the fact that the company was "in a financially precarious position and in urgent need of funds to remain solvent".[4] The Review Panel came to the same conclusion, having regard to the "commercial reality" that the company was in "extremely difficult financial circumstances" and that, as a result, it had to deal with the proposed creditor "regarding any financing proposal".[5]

From a drafting perspective, this could be accommodated by adding a new paragraph 11(f) which reads:

> *"(f) the financial situation and solvency of the target."*

(b) **Paragraph 13**

Paragraph 13 states that there is no requirement for a target to undertake an auction process prior to entry into any deal protection arrangements, but that where there has not been any auction process prior to entry into the arrangements, the Panel will consider what processes and analyses have been undertaken and what advice has been obtained by the target. Here, the Committee assumes that the references to an "auction process" are meant to include an informal auction process, in which the target approaches a range of likely interested parties on a confidential basis, as well as the situation where the target announces a formal auction process. This could perhaps be made clear in paragraph 13.

Question 3

Is the guidance on an effective 'fiduciary out' useful (see paragraphs 35 to 38)? Please explain.

8. Yes, although the Committee thinks that the Revised Guidance Note should have a better description/definition of what is meant by a 'fiduciary out', and the circumstances in which it applies.

[4] [2012] ATP 19 at [44].

[5] [2012] ATP 20 at [20].

9. A typical form of ‘fiduciary out’ states that the relevant exclusivity provisions (i.e. the no-talk and the no-due diligence obligations) do not prevent the target or its board or representatives from taking or refusing to take any action with respect to a bona fide actual or proposed competing proposal (which was not solicited in breach of any no-shop) provided that the target board, acting in good faith, has determined:

   (a) after consultation with its financial and legal advisors, that such competing proposal is, or could reasonably be expected to lead to, a superior proposal; and

   (b) after receiving written legal advice from its external legal advisers, that failing to respond to such competing proposal, or failure to take or not take the action which would otherwise breach the exclusivity provision, would, or would be reasonably likely to, constitute a breach of any of the target directors’ fiduciary or statutory duties.

10. For this purpose, a ‘superior proposal’ is typically defined as a bona fide competing proposal (which was not solicited in breach of the no-shop) which the target board, acting in good faith and after having obtained written advice from the target’s financial and legal advisers is:

   (a) reasonably capable of being valued, and reasonably capable of being completed within a reasonable timeframe; and

   (b) would, if completed substantially in accordance with its terms, be more favourable to target shareholders than the existing proposal.

11. It may be helpful if the Revised Guidance Note actually gave this as an example of an effective ‘fiduciary out’, and made it clear that any additional fetters or constraints, beyond those set out above, on the ability of the target to rely on the fiduciary out (such as those listed in paragraph 36) will generally be unacceptable.

12. In addition to the above, the Committee suggests the following changes to paragraph 36, and related paragraphs, in the Revised Guidance Note:

   (a) **Incorporation of references to existing judicial statements**

   To further enhance the usefulness of the Revised Guidance Note, the Panel should reference all of the additional principles that have emerged from various judicial decisions on ‘fiduciary outs’.[6]

   Gathering all of the relevant decisions in one place would help to contextualise the Panel’s position in light of the existing judicial guidance and would provide a useful consolidated reference point for market participants. Those judicial decisions are broadly consistent with the Panel’s proposed position in the Revised Guidance Note.

[6] Those judicial decisions are discussed in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks: The Use of Schemes of Arrangement*, Fourth Edition, The University of Sydney, Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2021, at 1,000-1,011 [7.3.4].

From a drafting perspective, this could be accommodated by making the following changes in paragraph 36:

(1) adding a new subparagraph (c)(iv) which explains that there may be an unacceptable fetter or constraint if:

> "it is specified that the 'fiduciary out' can only be relied on if the board is acting 'unanimously' [Footnote: *Re Terry White Group Ltd (No 1)* [2018] QSC 254 at 9–10] or 'reasonably' [Footnote: *Re NetComm Wireless Ltd* [2019] FCA 795 at [14] and *Re Real Energy Corporation Ltd* [2020] FCA 1634 at [22]–[25]]"; and

(2) adding a new subparagraph (c)(v) which explains that there may be an unacceptable fetter or constraint:

> "where the 'fiduciary out' can only be enlivened if the target board receives advice from its lawyers to the effect that failing to respond to the competing bid 'would' or 'would be likely' to cause the directors to breach their duties—the content or conclusion of the advice should not be prescribed [Footnote: *Re Perseverance Corporation Ltd* [2007] VSC 574 at [16]–[17] and *Re David Jones Ltd* [2014] FCA 530 at [21]]".

Consistent with the proposed new subparagraph (c)(v) above (and the case law referred to therein), paragraph (b) should be amended as follows:

> "additional requirements are imposed on how the target board should act beyond requiring the target to obtain:
>
> (i) legal and/or financial advice ~~that~~ as to whether a competing proposal could reasonably be considered to become a superior proposal"; and
>
> (ii) legal advice ~~that~~ as to whether failing to respond to a competing proposal would, or would be reasonably likely to, breach the any of the director's statutory or fiduciary duties."

(b) **Clarification of decision in *Re Magna Pacific Holdings Limited 02* [2007] ATP 03**

Paragraph 36(c)(ii) of the Revised Guidance Note explains that there may be an unacceptable fetter or constraint if:

> "where the terms of the exclusivity arrangements require a superior proposal before the 'fiduciary out' can be relied upon (rather than to allow the target board to respond to a competing proposal which "would be likely" to constitute a breach of those duties)".

The wording in brackets is slightly unclear in that it does not specify whose determination is relevant to the phrase "would be likely". In our view, consistent with the approach of the Panel in decided cases and consistent also with the relevant judicial decisions, we consider that a more appropriate formulation for the text in brackets would be:

> "(rather than to allow the target board to respond to a competing proposal which <u>the target board considers</u> "would be likely" to constitute a breach of those duties)".

This would be consistent with paragraph [28] of *Re Magna Pacific Holdings Limited 02* [2007] ATP 03, which states:

> "The Panel considered it overly onerous to require legal advice that "failing to respond **would** breach their fiduciary duties" (emphasis added) and this may have effectively rendered the fiduciary exception meaningless. The Panel would have been more comfortable to leave the decision to the directors having a reasonable basis to believe that failing to respond would be likely to breach their fiduciary duties."

Interestingly, footnote 28 of the Revised Guidance Note refers to paragraphs [31]–[32] of *Re Magna Pacific Holdings Limited 02* [2007] ATP 03, instead of paragraph [28]. In our view, the Panel should consider amending footnote 28 to also refer to paragraph [28] from *Re Magna Pacific Holdings Limited 02* [2007] ATP 03.

The position set out in paragraph [28] aligns with the Court's approach to the issue in *Re Perseverance Corporation Ltd* [2007] VSC 574, where Robson J stated at [16]:

> "The duty of directors is a personal and subjective one and, in my view, the duty should not be overborne by the advice of lawyers, although clearly their duty can be informed by external advice and should in a difficult case be so informed".

(c) **Typo in footnote 30**

Footnote 30 of the Revised Guidance Note contains an incorrect citation. The correct citation should be:

> "*Re Queensland Cotton Holdings Limited* [2007] ATP 5 at [28]".

(d) **Application of 'fiduciary out' to matching right regime**

The Panel should take the opportunity to clarify its position in relation to the application of 'fiduciary outs' to a matching right regime.

The Courts have long accepted that matching rights do *not* need to be subject to a 'fiduciary out': see, for example, *Re Healthscope Ltd* [2010] VSC 367 at [22]–[23]; *Re Tatts Group Ltd* [2017] VSC 552 at [41]; *Re Mantra Group Ltd* [2018] FCA 510 at [32]; *Re Watpac Ltd* [2018] FCA 656 at [46]; *Re Kidman Resources Ltd* [2019] FCA 1226 at [55]; *Re QMS Media Ltd* [2019] FCA 2172 at [54].

From a drafting perspective, this could be accommodated by adding a new sentence at the end of paragraph 32 in the matching right section of the Revised Guidance Note which states:

> “There is no requirement for matching rights to be subject to a fiduciary out.”

Question 4

Do you agree with the Panel’s approach to ‘hard’ exclusivity arrangements agreed in respect of non-binding proposals? Do you consider that a short period of ‘hard’ exclusivity is not unacceptable in certain limited circumstances (and do you have any comments on the example circumstances described in paragraph 43)? If yes, is the proposed acceptable ‘hard’ exclusivity period of up to 4 weeks in which exclusive access to non-public due diligence is provided appropriate? Please explain.

13. Yes, the Committee generally agrees with the Panel’s approach to ‘hard’ exclusivity agreed in respect of non-binding proposals. As discussed above, the Committee thinks that the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, but that there may be situations where the target board appropriately determines that it is necessary to grant exclusivity with a fiduciary out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal. So yes, the Committee agrees that ‘hard exclusivity’ should not be per se unacceptable.

14. The Committee did not have any material comments on the examples in paragraph 43 where ‘hard exclusivity’ may be justified, other than to note that the references in paragraph 43(c) to extracting a ‘material price increase’ from the existing bidder should make it clear that the ‘material price increase’ will itself be non-binding and indicative only.

15. As to the period, the Committee thinks it is useful to state a maximum ‘hard’ exclusivity period, and that the maximum should be 4 weeks, beyond which the ‘hard’ exclusivity may unduly impact the market for control of the target. While private equity bidders may argue that they are disadvantaged by this versus a trade bidder, as the private equity bidder may require a longer period of due diligence than the trade bidder, the Committee thinks a fixed maximum period is clearer, and appropriate.

Question 5

Do you agree with the Panel’s position on break fees in respect of non-binding proposals (see paragraph 49)? Please explain.

16. The Committee agrees with the first sentence in paragraph 49, but the statement in the second sentence of paragraph 49 suggesting that a break fee is acceptable if it is ‘substantially lower’ than for an equivalent binding proposal is unclear, and potentially unhelpful.

17. The Committee thinks that the starting point should be that an obligation on the target to pay a break fee in respect of a non-binding proposal should be unacceptable, but that, in certain limited circumstances, it may be acceptable for the target to agree to reimburse the bidder for its actual external adviser costs in conducting due diligence during the exclusivity period, up to an agreed cap (which itself should generally speaking not exceed the lower of 0.1 per cent of deal value and $1 million, but recognising that 0.1 per cent may be inappropriately low in the case of a small transaction). The examples in paragraph 43 may also be examples of situations where it may be appropriate for the target to agree to such cost reimbursement. Typically, the cost reimbursement would only apply if the target terminates the due diligence access during the exclusivity period (at a time when the bidder is continuing to undertake material work and has confirmed its indicative price), or if at the end of the period the bidder puts a binding proposal at or above the original indicative offer, which the target board decides not to recommend.

Question 6

Do you agree that deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal (see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain.

18. Generally yes, although disclosure should not necessarily be required where the notification obligation simply requires the target to notify the existing bidder of the fact that the target has received a potential competing proposal, without having to identify the competing bidder or the terms of the potential competing proposal.

19. If, in the context of a confidential non-binding indicative proposal, the target is required to notify the existing bidder if the target receives a competing proposal (including the identity of the third party making the competing proposal and its terms), this has the potential to operate as a de-facto exclusivity arrangement, as the third party will not be previously aware of the existing bidder and its proposal, and the third party will not want its identity and terms disclosed to the existing bidder. The anti-competitive effect of this notification obligation needs to be measured against the fact that the existing bidder's proposal is non-binding in any event.

20. The Committee does not think that this cuts across the exceptions in ASX LR 3.1A to require disclosure of such a notification obligation. The fact that there is an exception to the continuous disclosure obligations for a confidential and incomplete proposal or negotiation does not mean that a notification obligation which may unduly impact the market for control of a listed company should be permitted.

21. For the sake of completeness, the Committee notes that this type of notification obligation does not necessarily have the same anti-competitive effect where the existing proposal and the fact that the existing bidder is undertaking due diligence has previously been announced to the market, because the target will usually announce the receipt of the third party's competing proposal in any event (and the existing bidder will therefore be aware of it anyway), where the target has already announced the original bidder's proposal and the fact that the original bidder was in due diligence.

22. As flagged above, the position may be different, however, in the context of a confidential non-binding proposal, if the notification obligation simply requires the target to notify the existing bidder of the fact that an approach has been made, but not the identity of the person making it or its terms. Here, the Committee thinks that the existing bidder, who may think that they are dealing with the target on an exclusive basis, has a legitimate expectation that it be informed that that is no longer the case. Also, the fact that the existing bidder knows that there is another party on the scene does not unduly impact the potential competing bidder.

Question 7

> Do you agree with the other amendments made to the Guidance Note? Please identify any other amendments you think should be made.

23. The Committee considers that the following refinements should also be made to the Revised Guidance Note.

(a) **Paragraph 20**

This paragraph states:

> "Exclusivity arrangements are less likely to give rise to unacceptable circumstances if the target has conducted an auction or market testing process before agreeing to it or where the potential transaction has been in the market for a **long** period." (Emphasis added.)

The Committee considers that it would be more appropriate to use the phrase "reasonable period" instead of "long period", noting the inherent subjectivity of the word "long" (and the absence of any hard guidance of what length of time constitutes a "long period"). By contrast, the question of whether something is "reasonable" is more amenable to case-by-case evaluation having regard to the specific facts and circumstances of the case, which the Committee considers is appropriate in this context.

(b) **Paragraph 46, Footnote 36**

There have been a number of judicial decisions that have considered 'naked no vote' break fees as well. The Committee thinks it would be helpful to collate those in the Revised Guidance Note.

From a drafting perspective, this could be addressed by adding the following new wording at the end of footnote 36:

> "See also *Re Bolnisi Gold NL (No 2)* (2007) 65 ACSR 510 at 513 [12]; *Re Rusina Mining NL* at [2010] FCA 517 at [50]–[53]; *Re Airtrain Holdings Ltd* [2010] FCA 517 at [50]–[53]; *Re Atlantic Gold NL* [2014] FCA 697 at [30]; *Re Pulse Health Ltd* [2017] NSWSC 140 at [24]; *Re Creso Pharma Ltd* [2019] WASC 472 at [87]."

(c) **Paragraph 46**

This paragraph lists a number of reasonable triggers for a break fee. Subparagraph (e) says reasonable triggers include “other events affecting the bid (e.g. a major asset of the target is destroyed)”.

Whilst such “other events” would be appropriate as negative conditions precedent or termination rights, the Committee does not consider that such break fee triggers should automatically be suggested to the “reasonable”. To avoid confusion, the Committee would recommend that subparagraph (e) be deleted.

(d) **Paragraph 46(a)**

At the end of paragraph 46(a) of the Revised Guidance Note, the Committee suggests adding “or, in the case of a scheme of arrangement, that the transaction is in the best interest of shareholders”.

This would align the wording with the prescribed independent expert test for schemes of arrangement in regulation 8303 of the *Corporations Regulations 2001* (Cth).

(e) **Paragraph 47**

This states that, in considering whether a break fee gives rise to unacceptable circumstances, the Panel will be guided by a non-exhaustive list of factors. The Committee queries whether the Panel will really look at these factors where the break fee is 1 per cent or less, or whether the factors set out in paragraph 47 are meant to apply where the Panel is considering a break fee in excess of 1 per cent. The clear practice in the Australian market is to have a 1 per cent break fee, on the basis that a 1 per cent break fee subject only to the triggers in paragraph 46 ultimately does not have a material effect on the market for control of the target.[7]

The Committee would recommend deleting paragraph 47, or making it clear that it only applies where the Panel is considering a break fee in excess of 1 per cent.

In the alternative, the Committee would recommend including the following new footnote at the end of paragraph 47:

> “The mere fact that none of these factors was present in a particular transaction does not mean that the break fee in that transaction will constitute unacceptable circumstances.”

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[7] For example, in FY22 94 per cent of all negotiated public M&A deals contained a break fee (see Herbert Smith Freehills, *Australian Public M&A Report 2022*, at 34).

(f) **Paragraphs 29, 31 and 43(a)**

There are a few instances where the Panel should adjust its language to convey a *possibility* as opposed to *certainty*. In this regard, the Committee suggests the following amendments:

- **Paragraph 29**—amending “A notification obligation reduces” to “A notification obligation may reduce”;
- **Paragraph 31**—amending “it reduces” to “it may reduce”; and
- **Paragraph 43(a)**—amending “would incentivise” to “would likely incentivise”.

Annexure A: About the Business Law Section of the Law Council of Australia

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws adopted by the Law Council and the members of the Section. The Business Law Section conducts itself as a section of the Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, as well as enhance their professional skills.

The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Law Society of the Australian Capital Territory
- New South Wales Bar Association
- Law Society of New South Wales
- Northern Territory Bar Association
- Law Society Northern Territory
- Bar Association of Queensland
- Queensland Law Society
- South Australian Bar Association
- Law Society of South Australia
- Tasmanian Bar
- Law Society of Tasmania
- The Victorian Bar Incorporated
- Law Institute of Victoria
- Western Australian Bar Association
- Law Society of Western Australia
- Law Firms Australia

Operating as a section of the Law Council, the Business Law Section is often called upon to make or assist in making submissions for the Law Council in areas of business law applicable on a national basis.

Currently, the Business Law Section has approximately 900 members and also 15 specialist committees and working groups:

- Competition & Consumer Law Committee
- Construction & Infrastructure Law Committee
- Corporations Committee
- Customs & International Transactions Committee
- Digital Commerce Committee
- Financial Services Committee
- Foreign Corrupt Practices Working Group

- Foreign Investment Committee
- Insolvency & Reconstruction Law Committee
- Intellectual Property Committee
- Media & Communications Committee
- Privacy Law Committee
- SME Business Law Committee
- Taxation Law Committee
- Technology in Mergers & Acquisitions Working Group

As different or newer areas of business law develop, the Business Law Section evolves to meet the needs or objectives of its members in emerging areas by establishing new working groups or committees, depending on how it may better achieve its objectives.

The Section has an Executive Committee of 11 members drawn from different states and territories and fields of practice. The Executive Committees meet quarterly to set objectives, policy and priorities for the Section.

Current members of the Executive are:

- Mr Philip Argy, Chairman
- Professor Pamela Hanrahan, Deputy Chair
- Mr Adrian Varrasso, Treasurer
- Mr Greg Rodgers
- Mr John Keeves
- Ms Rachel Webber
- Ms Caroline Coops
- Dr Elizabeth Boros
- Ms Shannon Finch
- Mr Clint Harding
- Mr Peter Leech

The Section's administration team serves the Section nationally and is based in the Law Council's offices in Canberra.

Ksiezak, Karolina

From: Mant, Jonathon-GB+ <jonathon.mant@ubs.com>
Sent: Tuesday, 28 February 2023 9:17 PM
To: Takeovers
Cc: Brown, Nick-GB+
Subject: Confidential Submission on Revised Guidance Note 7
Attachments: disclaim.txt

Dear Panel Executive

UBS appreciates the opportunity to provide comments on the Takeovers Panel's proposed revisions to Guidance Note 7 – Deal protection (**GN 7**). The views expressed in this submission are the views of the M&A advisory team only, and do not necessarily represent the views of others and in particular of any of our clients.

Please treat this submission as confidential.

1. General observations

UBS largely agrees with and supports the Panel's proposals to revise GN 7 to provide clearer guidance about the Panel's expectations in relation to deal protections. We agree that target boards should think carefully before entering into deal protection arrangements at the non-binding stage – and seek to negotiate and test a bidder's proposed deal protection devices where possible – but that there are also situations when limited deal protection arrangements at this stage may be appropriate.

Our submission relates substantively to the proposed changes in relation to disclosure of deal protection arrangements where they include notification obligations, as set out below.

2. Specific submissions

Do you agree that deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal (see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain.

While we agree with the Panel's expectation that all material terms of deal protection arrangements should be disclosed by the time a control proposal is announced, UBS does not agree that deal protection arrangements should necessarily be disclosed where a notification obligation has been agreed as part of those arrangements in respect of an otherwise confidential non-binding proposal before a control proposal is agreed.

The Panel's concern appears to be that a competing bidder should be aware that there is a prospect that information in respect of its proposal might be shared by a target under a notification obligation. However, the Panel's proposal goes further than is necessary to address that concern.

Notification obligations are frequently important to bidders, who might otherwise not be prepared to deploy significant resources to pursue a control transaction. Such bidders should not be deterred from approaching targets with proposals.

At the same time, maintaining confidentiality can be important to both bidders and targets – especially at early stages when a transaction is being explored and there is no guarantee that any binding proposal will eventuate, a target has a legitimate interest in not wanting to cause disruption and distraction amongst its employees, customers and suppliers.

Maintaining confidentiality at an early stage also assists to avoid unnecessary share price volatility in circumstances where there remains a strong chance that no transaction will eventuate.

Three better approaches would be to:

1. Impose no policy requirement to disclose notification obligations where they are agreed until a binding control proposal is announced. Irrespective of notification obligations which may be in place, parties approaching confidentially already take the risk that their confidential approaches will be disclosed, including to ASX.

2. Limit the requirement to disclose notification obligations to situations where the notification obligations extend to the identity of a party making the approach (the information which a party approaching would most likely be concerned to protect).

3. Only require disclosure to ASX of notification obligations which require a target to disclose an approach from a second bidder where the approach is in writing or from a second bidder who has not consented to its approach being disclosed (eg. because the target will not otherwise engage with it). So, for instance, it should be acceptable for a notification obligation to remain confidential before a control proposal is agreed if it operates so that:
    - if a second bidder approaches by phone with a view to presenting a proposal or presents a proposal, and that bidder is told by the target that it will only engage on that proposal on the basis that it reserves the right to disclose the bidder's interest and proposal to one or more third parties;
    - the second bidder advises the target that it would like to engage on those terms; and
    - on that basis, the target notifies the first bidder of the key aspects of the second bidder's proposal (under pre-existing mutual confidentiality obligations such that no disclosure is required under the Listing Rules).

    Under this approach, the second bidder would have the practical option to withdraw without its interest being disclosed to the first bidder addressing the Panel's apparent policy concern, but without compromising the capacity for notification obligations or the ongoing prosecution of two potential control proposals in confidence.

These three approaches would maintain opportunities to facilitate a confidential auction between two (or more) approaching parties to determine whether a proposal that the Board would recommend can be put to shareholders (which might then unlock a subsequent broader public auction), but without causing unnecessary distraction and disruption to the target company in circumstances where neither original proposal may result in a binding offer.

It seems to us that maintaining that possibility is in the best interests of an efficient, competitive and informed market for corporate control.

Yours sincerely,

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1 Introduction

On 14 December 2023, the Takeovers Panel (**Takeovers Panel** or **Panel**) published a consultation paper inviting comments on its drat revised 'Guidance Note 7 – Deal protection' (**Revised Guidance Note**). This submission has been prepared by Allens in response to that consultation paper.

Unless otherwise stated, all references to paragraph and footnote numbers in this submission are references to the paragraph and footnote numbers used in the Revised Guidance Note.

2 Responses to specific questions

2.1 Question 1

Do you agree that the principles in the Revised Guidance Note should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals? Please explain.

Yes, the basic principle – that deal protection arrangements entered into by the target should not unduly fetter the market for control of the target – should generally apply to deal protection arrangements entered into in respect of both binding and non-binding proposals. However, different considerations apply at each stage, and there are significant differences between what is acceptable at the binding transaction phase versus what may be acceptable at the non-binding bid phase. For example, at the non-binding bid phase, where the target has received a confidential non-binding indicative proposal subject to due diligence and entry into a binding implementation agreement, the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, while recognising that there may be situations where the target board determines that it is necessary to grant exclusivity with a fiduciary out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal. However, the position is different once the bidder has put forward a binding proposal, which may justify a broader suite of deal protection arrangements (e.g. matching rights; notification obligations and equal access obligations), although any no-talk must be subject to a fiduciary carve-out, particularly where the arrangements will continue for a period of potentially 6 months or more.

In our view, the Revised Guidance Note would benefit greatly from some re-drafting to: (a) more fully explain the different considerations at the non-binding proposal stage versus the binding transaction phase; and (b) to capture in one place in the Revised Guidance Note the rules which apply during the non-binding proposal stage. At the moment, there is a section on the "Non-binding bid stage" (paragraphs 39-45) which largely deals with hard exclusivity, but the rules relating to other deal protection arrangements in the non-binding proposal stage, such as break fees, notification obligations and matching rights, are found elsewhere throughout the document. To make the Revised Guidance Note easier to read, we would suggest that the Revised Guidance Note deal firstly with the rules applying at the binding transaction phase, and then have a separate section which explains the different considerations, and what the rules are, at the non-binding proposal stage. That separate section could emphasise the point made in the *Virtus* and *AusNet* decisions that the Panel will look at the various deal protection provisions as a whole.

In our view, the Revised Guidance Note also needs to more fully explain the rules which apply at the non-binding proposal phase. For example:

- As discussed above, the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, while recognising that there may be situations where the target board determines that it is necessary to grant exclusivity with a fiduciary out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal.
- On break fees in respect of non-binding proposals, the Revised Guidance Note states (at paragraph 19) that "the Panel does not expect" that a target board would agree to a break fee in respect of a non-binding proposal, but then suggests that a break fee would not be unacceptable if it was "substantially lower", without any indication of what that means. A reference to actual out-of-pocket external adviser costs would be a helpful starting point. The Revised Guidance Note also does not address cost reimbursement arrangements in the non-binding proposal stage, which have been a feature of a number of 'process deeds' entered into over the past few years. There is also the issue, which arose in *Virtus*, whether the break fee/cost reimbursement fee which is payable in circumstances where the target terminates the discussions for a competing proposal should be no higher than the cost reimbursement fee which is payable where the bidder puts a binding proposal at the original indicative price, but the target board decides not to recommend.
- On matching rights, there is no real discussion of whether they should apply and, if so, how they should apply, in relation to a non-binding proposal. In our view, matching rights are not really appropriate where the proposals are non-binding and can be withdrawn by the bidder(s) at any time anyway. Matching rights in respect of non-binding proposals can lead to the situation where each of the existing bidder continues to increase its indicative price simply to maintain the exclusivity, in circumstances where it will not ultimately be held to that increased price.[1]
- On notification obligations, the Revised Guidance Note does not fully differentiate between the situation where the proposal remains confidential versus where it is not; nor does it focus on the nature and extent of the disclosure obligation (i.e. is it an obligation to notify the identity of the competing bidder and the full terms of the proposal, or simply for the target to notify the first party that the target is no longer dealing with it on an exclusive basis).
- On disclosure, the Revised Guidance Note should reflect the fact that usually there is no obligation under continuous disclosure rules to disclose the arrangements at the non-binding proposal phase, while the deal protection arrangements remain confidential, and because they concern an incomplete proposal or negotiation. However, the Revised Guidance Note could also make it clear that if a 'process deed' has been entered into under which the target board has agreed to recommend the transaction if the bidder puts a binding proposal on the terms of the indicative proposal (or if a material fee would be payable by the target if the target board fails to recommend a binding proposal on the same or better terms than the indicative proposal), then the carve-out to the continuous disclosure rules for an incomplete proposal or negotiation ceases to apply, and the 'process deed' should be disclosed.

[1] This was an issue in *Re Ludowici Ltd* [2012] ATP3 (see especially at [17]).

These issues are dealt with further below.

2.2 Question 2

> Are the general principles and factors that the Panel will have regards to in considering whether deal protection devices give rise to unacceptable circumstances useful (see paragraphs 8 to 16)? Do you agree with the approach set out? Please explain.

Yes. The guidance in paragraphs 8-16 is useful, and we generally agree with the approach set out. However, we have set out below a few specific comments in relation to some of the principles and factors discussed.

(a) **Paragraph 11**

In addition to the factors already listed in paragraph 11, if the target is in financial distress/approaching insolvency, the Panel should also be able to take this fact into account when considering whether a deal protection device gives rise to unacceptable circumstances.

This would be consistent with 'Guidance Note 17 – Rights issues', which indicates that the Panel will look at the "financial situation and solvency of the company" when considering whether a rights issue gives rise to unacceptable circumstances.[2]

It would also be consistent with the Panel's decision in *Re Mission NewEnergy Ltd* [2012] ATP 19 and *Re Mission NewEnergy Ltd (No 1R)* [2012] ATP 20, which involved a company with significant financial difficulties entering into a term sheet (which contained an exclusivity regime without a 'fiduciary out') with another party for the provision of a credit facility. In concluding that that there were no reasonable prospects of making a declaration of unacceptable circumstances, the Initial Panel took into account (among other things) the fact that the company was "in a financially precarious position and in urgent need of funds to remain solvent".[3] The Review Panel came to the same conclusion, having regard to the "commercial reality" that the company was in "extremely difficult financial circumstances" and that, as a result, it had to deal with the proposed creditor "regarding any financing proposal".[4]

From a drafting perspective, this could be accommodated by adding a new paragraph 11(f) which reads:

> *"(f) the financial situation and solvency of the target."*

(b) **Paragraph 13**

Paragraph 13 states that there is no requirement for a target to undertake an auction process prior to entry into any deal protection arrangements, but that where there has not been any auction process prior to entry into the arrangements, the Panel will consider what processes and analyses have been undertaken and what advice has been obtained by the target. Here, we assume that the references to an "auction process" are meant to include an informal auction process, in which the target approaches a range of likely interested parties on a confidential basis, as well as the situation where the target announces a formal auction process. This could perhaps be made clear in paragraph 13.

[2] Takeovers Panel, 'Guidance Note 17 – Rights issues', Issue 4, 27 June 2018 at [6(a)]. See also [10]-[12], which indicates that a company's need for funds may be relevant to whether a rights issue constitutes unacceptable circumstances.
[3] [2012] ATP 19 at [44].
[4] [2012] ATP 20 at [20].

2.3 Question 3

Is the guidance on an effective 'fiduciary out' useful (see paragraphs 35 to 38)? Please explain.

Yes, although we think that the Revised Guidance Note should have a better description/definition of what is meant by a 'fiduciary out', and the circumstances in which it applies.

A typical form of 'fiduciary out' states that the relevant exclusivity provisions (i.e. the no-talk and the no-due diligence obligations) do not prevent the target or its board or representatives from taking or refusing to take any action with respect to a bona fide actual or proposed competing proposal (which was not solicited in breach of any no-shop) provided that the target board, acting in good faith, has determined:

(a) after consultation with its financial and legal advisors, that such competing proposal is, or could reasonably be expected to lead to, a superior proposal; and

(b) after receiving written legal advice from its external legal advisers, that failing to respond to such competing proposal, or failure to take or not take the action which would otherwise breach the exclusivity provision, would, or would be reasonably likely to, constitute a breach of any of the target directors' fiduciary or statutory duties.

For this purpose, a 'superior proposal' is typically defined as a bona fide competing proposal (which was not solicited in breach of the no-shop) which the target board, acting in good faith and after having obtained written advice from the target's financial and legal advisers is:

(a) reasonably capable of being valued, and reasonably capable of being completed within a reasonable timeframe; and

(b) would, if completed substantially in accordance with its terms, be more favourable to target shareholders than the existing proposal.

It may be helpful if the Revised Guidance Note actually gave this as an example of an effective 'fiduciary out', and made it clear that any additional fetters or constraints, beyond those set out above, on the ability of the target to rely on the fiduciary out (such as those listed in paragraph 36) will generally be unacceptable.

In addition to the above, we would suggest the following changes to paragraph 36, and related paragraphs, in the Revised Guidance Note:

(a) **Incorporation of references to existing judicial statements**

To further enhance the usefulness of the Revised Guidance Note, the Panel may wish to reference all of the additional principles that have emerged from various judicial decisions on 'fiduciary outs'.[5]

Gathering all of the relevant decisions in one place would help to contextualise the Panel's position in light of the existing judicial guidance and would provide a useful consolidated reference point for market participants. Those judicial decisions are broadly consistent with the Panel's proposed position in the Revised Guidance Note.

From a drafting perspective, this could be accommodated by make the following changes in paragraph 36:

[5] Those judicial decisions are discussed in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks: The Use of Schemes of Arrangement*, Fourth Edition, The University of Sydney, Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2021, at 1,000-1,011 [7.3.4].

(1) adding a new subparagraph (c)(iv) which explains that there may be an unacceptable fetter or constraint if:

"it is specified that the 'fiduciary out' can only be relied on if the board is acting 'unanimously' [Footnote: *Re Terry White Group Ltd (No 1)* [2018] QSC 254 at 9-10] or 'reasonably' [Footnote: *Re NetComm Wireless Ltd* [2019] FCA 795 at [14] and *Re Real Energy Corporation Ltd* [2020] FCA 1634 at [22]-[25]]"

(2) adding a new subparagraph (c)(v) which explains that there may be an unacceptable fetter or constraint:

"where the 'fiduciary out' can only be enlivened if the target board receives advice from its lawyers to the effect that the failing to respond to the competing bid 'would' or 'would be likely' to cause the directors to breach their duties – the content or conclusion of the advice should not be prescribed [Footnote: *Re Perseverance Corporation Ltd* [2007] VSC 574 at [16]-[17] and *Re David Jones Ltd* [2014] FCA 530 at [21]]".

(b) **Content or conclusion of advice should not be prescribed**

Consistent with the proposed new subparagraph (c)(v) above (and the case law referred to therein), paragraph 36(b) should be amended as follows:

"additional requirements are imposed on how the target board should act beyond requiring the target to obtain:

(i) legal and/or financial advice ~~that~~ <u>as to whether</u> a competing proposal could reasonably be considered to become a superior proposal"; and

(ii) legal advice ~~that~~ <u>as to whether</u> failing to respond to a competing proposal would, or would be reasonably likely to, breach the any of the director's statutory or fiduciary duties."

(c) **Clarification of decision in *Re Magna Pacific Holdings Limited 02* [2007] ATP 03**

Paragraph 36(c)(ii) of the Revised Guidance Note explains that there may be an unacceptable fetter or constraint if:

"where the terms of the exclusivity arrangements require a superior proposal before the 'fiduciary out' can be relied upon (rather than to allow the target board to respond to a competing proposal which "would be likely" to constitute a breach of those duties)".

The wording in brackets is slightly unclear in that it does not specify whose determination is relevant to the phrase "would be likely". In our view, consistent with the approach of the Panel in decided cases and consistent also with the relevant judicial decisions, we consider that a more appropriate formulation for the text in brackets would be:

"(rather than to allow the target board to respond to a competing proposal which <u>the target board considers</u> "would be likely" to constitute a breach of those duties)".

This would be consistent with paragraph [28] of *Re Magna Pacific Holdings Limited 02* [2007] ATP 03, which states:

"The Panel considered it overly onerous to require legal advice that "failing to respond **would** breach their fiduciary duties" (emphasis added) and this may have effectively rendered the fiduciary exception meaningless. The Panel would have been more comfortable to leave the decision to the directors having a reasonable basis to believe that failing to respond would be likely to breach their fiduciary duties."

Interestingly, footnote 28 of the Revised Guidance Note refers to paragraphs [31]-[32] of *Re Magna Pacific Holdings Limited 02* [2007] ATP 03, instead of paragraph [28]. In our view, the Panel should consider amending footnote 28 to also refer to paragraph [28] from *Re Magna Pacific Holdings Limited 02* [2007] ATP 03.

The position set out in paragraph [28] aligns with the Court's approach to the issue in *Re Perseverance Corporation Ltd* [2007] VSC 574, where Robson J stated at [16]:

> "The duty of directors is a personal and subjective one and, in my view, the duty should not be overborne by the advice of lawyers, although clearly their duty can be informed by external advice and should in a difficult case be so informed".

(d) **Application of 'fiduciary out' to matching right regime**

The Panel should take the opportunity to clarify its position in relation to the application of 'fiduciary outs' to a matching right regime.

The Courts have long accepted that matching rights do *not* need to be subject to a 'fiduciary out': see, for example, *Re Healthscope Ltd* [2010] VSC 367 at [22]-[23]; *Re Tatts Group Ltd* [2017] VSC 552 at [41]; *Re Mantra Group Ltd* [2018] FCA 510 at [32]; *Re Watpac Ltd* [2018] FCA 656 at [46]; *Re Kidman Resources Ltd* [2019] FCA 1226 at [55]; *Re QMS Media Ltd* [2019] FCA 2172 at [54].

From a drafting perspective, this could be accommodated by adding a new sentence at the end of paragraph 32 in the matching right section of the Revised Guidance Note which states:

> "There is no requirement for matching right to be subject to a fiduciary out."

2.4 Question 4

Do you agree with the Panel's approach to 'hard' exclusivity arrangements agreed in respect of non-binding proposals? Do you consider that a short period of 'hard' exclusivity is not unacceptable in certain limited circumstances (and do you have any comments on the example circumstances described in paragraph 43)? If yes, is the proposed acceptable 'hard' exclusivity period of up to 4 weeks in which exclusive access to non-public due diligence is provided appropriate? Please explain.

Yes, we generally agree with the Panel's approach to 'hard' exclusivity agreed in respect of non-binding proposals. As discussed above, the default position for a target board, if it decides to grant due diligence access, should be that such access is on a non-exclusive basis, but that there may be situations where the target board appropriately determines that it is necessary to grant exclusivity with a fiduciary out (and potentially a short period of hard exclusivity) in order to facilitate a potential control proposal. So yes, we agree that 'hard exclusivity' should not be per se unacceptable.

We did not have any material comments on the examples in paragraph 43 where 'hard exclusivity' may be justified, other than to note that the references in paragraph 43(c) to extracting a 'material price increase' from the existing bidder should make it clear that the 'material price increase' will itself be non-binding and indicative only.

As to the period, it is useful to state a maximum 'hard' exclusivity period, and that the maximum should be 4 weeks, beyond which the 'hard' exclusivity may unduly impact the market for control of the target. While private equity bidders may argue that they are disadvantaged by this versus a trade bidder, as the private equity bidder may require a longer period of due diligence than the trade bidder, we think a fixed maximum period is clearer, and appropriate.

2.5 Question 5

Do you agree with the Panel's position on break fees in respect of non-binding proposals (see paragraph 49)? Please explain.

We agree with the first sentence in paragraph 49, but the statement in the second sentence of paragraph 49 suggesting that a break fee is acceptable if it is 'substantially lower' than for an equivalent binding proposal is unclear, and potentially unhelpful.

In our view, the starting point should be that an obligation on the target to pay a break fee in respect of a non-binding proposal should be unacceptable, but that, in certain limited circumstances, it may be acceptable for the target to agree to reimburse the bidder for its actual external adviser costs in conducting due diligence during the exclusivity period, up to an agreed cap (which itself should generally speaking not exceed the lower of 0.1% of deal value and $1m, but recognising that 0.1% may be inappropriately low in the case of a small transaction). The examples in paragraph 43 may also be examples of situations where it may be appropriate for the target to agree to such cost reimbursement. Typically, the cost reimbursement would only apply if the target terminates the due diligence access during the exclusivity period (at a time when the bidder is continuing to undertake material work and has confirmed its indicative price), or if at the end of the period the bidder puts a binding proposal at or above the original indicative offer which the target board decides not to recommend.

2.6 Question 6

Do you agree that deal protection arrangements should be disclosed where a notification obligation has been agreed as part of those arrangements in respect of a non-binding proposal (see paragraph 53)? Does this have the potential to cut across the continuous disclosure provisions and the exceptions in Listing Rule 3.1A? Please explain.

Generally yes, although disclosure should not necessarily be required where the notification obligation simply requires the target to notify the existing bidder of the fact that the target has received a potential competing proposal, without having to identify the competing bidder or the terms of the potential competing proposal.

If, in the context of a confidential non-binding indicative proposal, the target is required to notify the existing bidder if the target receives a competing proposal (including the identity of the third party making the competing proposal and its terms), this has the potential to operate as a de-facto exclusivity arrangement, as the third party will not be previously aware of the existing bidder and its proposal, and the third party will not want its identity and terms disclosed to the existing bidder. The anti-competitive effect of this notification obligation needs to be measured against the fact that the existing bidder's proposal is non-binding in any event.

We do not think that this cuts across the exceptions in ASX LR 3.1A to require disclosure of such a notification obligation. The fact that there is an exception to the continuous disclosure obligations for a confidential and incomplete proposal or negotiation does not mean that a notification obligation which may unduly impact the market for control of a listed company should be permitted.

For sake of completeness, we note that this type of notification obligation doesn't necessarily have the same anti-competitive effect where the existing proposal and the fact that the existing bidder is undertaking due diligence has previously been announced to the market, because the target will usually announce the receipt of the third party's competing proposal in any event (and the existing bidder will therefore be aware of it anyway), where the target has already announced the original bidder's proposal and the fact that the original bidder was in due diligence.

As flagged above, the position may be different, however, in the context of a confidential non-binding proposal, if the notification obligation simply requires the target to notify the existing bidder of the fact that an approach has been made, but not the identity of the person making it or its terms. Here, the existing bidder, who may think that they are dealing with the target on an exclusive basis, has a legitimate expectation that it be informed that that is no longer the case. Also, the fact that the existing bidder knows that there is another party on the scene does not unduly impact the potential competing bidder.

2.7 Question 7

> Do you agree with the other amendments made to the Guidance Note? Please identify any other amendments you think should be made.

We would suggest the following additional amendments to the Revised Guidance Note.

(a) **1% break fee – paragraph 47**

Paragraph 47 states that, in considering whether a break fee gives rise to unacceptable circumstances, the Panel will be guided by a non-exhaustive list of factors. We query whether the Panel will really look at these factors where the break fee is 1% or less, or whether the factors set out in paragraph 47 are meant to apply where the Panel is considering a break fee in excess of 1%. The clear practice in the Australian market is to have a 1% break fee, on the basis that a 1% break fee, which is itself subject only to the triggers in paragraph 46, ultimately does not have a material effect on the market for control of the target.

We would recommend deleting paragraph 47, or making it clear that it only applies where the Panel is considering a break fee in excess of 1%.

(b) **Paragraph 20**

This paragraph states:

> "Exclusivity arrangements are less likely to give rise to unacceptable circumstances if the target has conducted an auction or market testing process before agreeing to it or where the potential transaction has been in the market for a **long** period." (Emphasis added.)

Here, it may be more appropriate to use the phrase "reasonable period" instead of "long period", noting the inherent objectivity of the word "long" (and the absence of any hard guidance of what length of time constitutes a "long period"). By contrast, the question of whether something is "reasonable" is more amenable to case-by-case evaluation having regard to the specific facts and circumstances of the case, which is appropriate in this context.

(c) **Paragraph 46, Footnote 36**

There have been a number of judicial decisions that have considered 'naked no vote' break fees as well. It would be helpful to collate those in the Revised Guidance Note.

From a drafting perspective, this could be addressed by adding the following new working as the end of footnote 36:

"See also *Re Bolnisi Gold NL (No 2)* (2007) 65 ACSR 510 at 513 [12]; *Re Rusina Mining NL* at [2010] FCA 517 at [50]-[53]; *Re Airtrain Holdings Ltd* [2010] FCA 517 at [50]-[53]; *Re Atlantic Gold NL* [2014] FCA 697 at [30]; *Re Pulse Health Ltd* [2017] NSWSC 140 at [24]; *Re Creso Pharma Ltd* [2019] WASC 472 at [87]."

(d) **Paragraph 46**

This paragraph lists out a number of reasonable triggers for a break fee. Subparagraph (e) says reasonable triggers include "other events affecting the bid (eg, a major asset of the target is destroyed)".

Whilst such "other events" would be appropriate as negative conditions precedent or termination rights, we not consider that such break fee triggers should automatically be suggested to the "reasonable". To avoid confusion, we would recommend that subparagraph (e) be deleted.

(e) **Paragraph 46(a)**

At the end of paragraph 46(a) of the Revised Guidance Note, we suggests adding "or, in the case of a scheme of arrangement, that the transaction is in the best interest of shareholders".

This would align the wording with the prescribed independent expert test for schemes of arrangement in regulation 8303 of the *Corporations Regulations 2001* (Cth).

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3 March 2023

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AUSTRALIAN SHAREHOLDERS' ASSOCIATION – CONSULTATION ON TAKEOVERS PANEL GUIDANCE NOTE 7 AND 19

Dear Mr Bulman

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, self-managed superannuation fund (SMSF) trustees and investors generally seeking ASA's representation and support.

Thank you for the opportunity to submit comments to the *Consultation on Guidance Notes 7 Deal Protection and 19 Insider Participation in Control Transactions.*

We support the added clarification in the proposed update to the guidance notes.

Retail shareholders often feel marginalised and uncertain when control transactions are under proposal. In part this is due to the lengthy process to get to the point of shareholders voting on a scheme or being made aware there will be no scheme, but also reflects the information asymmetry. Retail investors generally experience greater information asymmetry than professional investors, given their diverse backgrounds and their carrying out investing while usually generating income by non-investment employment or roles. They don't have the time to keep up to date with specific drawn out control transactions or to research how they usually proceed or terminate.

Guidance Notes such as these are helpful in providing context and setting expectations for the retail shareholder.

We also highlight the importance of retail shareholders being kept informed of a likely timetable for the deal contemplation, and advised as quickly as possible when it becomes apparent that a deal will not eventuate.

Guidance Note 7: Deal Protection

We agree with the recognition of the complexity in and dynamic nature of the target board's role in responding to a control transaction proposal, and the need for target boards to balance all relevant circumstances. We support the Panel expectation that target boards will reject deal protection devices that individually or in aggregate have the effect of reducing meaningful competition for control.

Guidance Note 19: Insider participation in control transactions

We support the broadening of the definition of insider participation to capture a shareholder with material non-public information obtained through its nominee on the target board.

If you have any questions about these comments or other matters, please do not hesitate to contact me (ceo@asa.asn.au), or Fiona Balzer, Policy & Advocacy Manager (policy@asa.asn.au).

Yours sincerely

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