HERBERT SMITH FREEHILLS

Allan Bulman
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20 February 2023
By Email

Dear Allan

Consultation paper GN19 – insider participation in control transactions

I am supportive of the draft guidance note. However, there is one important scenario which has caused issues in practice, which should be addressed.

It relates to the situation where there is an offer of **stub equity** in a transaction. As you would know, stub equity typically has the following features:

- It involves an offer (usually as an alternative to a cash offer) of shares in an unlisted entity, which are unattractive to most shareholders, yet are offered to all shareholders on seemingly equal terms to support the argument that all shareholders are being treated equally and can vote together in the same class. The shares are typically illiquid and have no ascertainable value; and
- It is designed to appeal to an insider or key shareholder (often a founder) who is likely to have different investment perspectives and who often would be involved (directly or indirectly) in agreeing the terms of the equity to be offered (to ensure it meets their requirements to support the transaction). This would usually include special veto rights over corporate actions, rights to appoint a director and right to participate in future capital raisings if the holder's stake exceeds a certain percentage, say 10 or 15%. Often the votes the insider can cast are crucial to satisfying the scheme thresholds and deterring rival bidders.

A director (or other insider) who has agreed or intends to take up an offer of stub equity for all or a substantial part of their shareholding should be regarded as a 'participating insider' with the meaning of paragraph 8 of the draft guidance note. Their interests diverge from the interests of other shareholders at that point. They become indifferent to the cash price offered under the bid (and, in fact, arguably benefit from a lower cash price given their on-going investment post-bid, an obvious conflict).

That outcome seems covered by the reference to 'proposes to enter into an agreement' in 8(a), but the position is complicated by 10(c) which excludes participation 'on the same terms as afforded to all other shareholders'.

My first suggestion is that you address 10(c). On one hand, it is arguable that all shareholders can take up the stub equity, but, in reality, an offer of unlisted scrip is unattractive to the vast majority of shareholders and is not a genuine alternative. That is outside the spirit and intent of 10(c). This would be exacerbated where one or more shareholders, by virtue of their shareholding size, would receive special rights (eg a right to appoint a director or veto rights if their stake in the unlisted entity exceeds 10 or 15%). At that point, those insiders are akin to a joint bidder.

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I suggest that you amend 10(c) or add a footnote to the effect that:

> *If the transaction includes an offer of equity which is unlikely to be appealing to most shareholders (for example, it is unlisted) or the equity confers special advantages or rights if the shareholder holds a stake of a certain size (as is the typical case with stub equity), the Panel will look to the substance over the form and not regard that as affording equal participation rights. Therefore, any understanding or agreement or proposed agreement with an insider will not be within this exception.*

My second suggestion is that the GN address an important issue about timing. It is sometimes argued that, until final elections are made, there is no agreement with the insider to take up the stub equity and the insider may say that they have not or cannot form an intention until the transaction terms are settled. Therefore, until that time, they argue that they are not 'participating insiders'. That strikes me as superficial and wrong. The danger of conflicts arises as soon as the idea of stub equity is floated.

The appropriate course of action is to treat the director (or other insider) as a participating insider unless they are willing to *rule out* the possibility of them taking up any stub equity or commit to taking it up for no more than a small portion of their shareholding. That may seen harsh, but I think it is the only way to deal with the conflict. Unless they do that, I do not believe that they can bring (or be seen to bring) an independent mind to the transaction. An IBC excluding them should be formed so that they are not involved in discussions about whether or not to support the cash offer under the transaction.

I suggest a further note or footnote be added to paragraph 15 as follows:

> *If the proposed bid includes an offer of unlisted stub equity, an insider may be regarded as lacking independence unless and until they rule out taking up the equity or commit to taking it up for no more than a small portion of their shareholding. An IBC may need to be formed immediately excluding a director who does not do so.*

I would be happy to chat to you further.

Kind regards.

Yours sincerely

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27 February 2023

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Dear Allan

Consultation Paper – Guidance Note 19 – Insider Participation in Control Transactions

We are grateful for the opportunity to provide comments in response to the Takeover Panel's Consultation Paper on Guidance Note 19 – *Insider Participation in Control Transactions* (**Consultation Paper**). This letter sets out Arnold Bloch Leibler's comments on the Consultation Paper and our responses to the questions posed by the Panel.

We embrace updated guidance from the Panel on insider participation in control transactions, it being more than 15 years since Guidance Note 19 was last amended. In particular, we welcome the Panel's proposals to set out a non-exhaustive list of factors that may give rise to unacceptable circumstances based on recent Panel decisions, and to provide examples of the orders that the Panel may make where it finds that unacceptable circumstances have arisen.

However, we are concerned with Questions 1 and 3 of the Consultation Paper. Our view is that:

- The definition of "insider" should not be extended to include a shareholder with material non-public information (**MNPI**) in relation to a target obtained through that shareholder's nominee on the target board (an **Affected Shareholder**).

- This is because the guidance provided under paragraphs 11 to 14 of the Consultation Paper with respect to "insiders" expects Affected Shareholders to comply with a series of positive duties to the target, which would be an anomaly at general law and does so without clear principled justification.

- Further, the application of these positive duties would interfere with Affected Shareholders' fundamental proprietary rights to deal with their shares for their personal advantage and without having regard to the interests of the target or other shareholders.

- The guidance also threatens to inhibit the ability for control transactions to take place in a "competitive" market (a key policy principle of the Consultation Paper), by having the potential to compromise deal making with Affected Shareholders and, more broadly, targets with Affected Shareholders on their register.

We limit our comments to Questions 1 and 3. We have addressed these two questions together given that the question of whether the definition of "insider" should be expanded must be considered in light of the consequences of being an "insider", which are, for the most part, set out in paragraphs 11 to 14 of the Consultation Paper.

1 Invitation to comment

Question 1: Do you agree with the updated definition of insider?

Question 3: Do you agree with the guidance provided (in paragraphs 11 to 14) in relation to when an insider should notify the board or any relevant sub-committee of the target of any approaches that might lead to a control proposal?

2 Expanded definition of "insider"

Background

2.1 We disagree that the definition of "insider" should be expanded to capture Affected Shareholders.

2.2 Under paragraphs 11 to 14 the Consultation Paper, the Panel expects or considers that "insiders" should comply with a series of positive obligations in favour of the target, including to:

(a) notify the target board (or relevant sub-committee) of approaches which "might lead to a control proposal", with the expectation that this notification occurs prior to entry into any arrangement with the prospective bidder which "might curtail the board's opportunity to consider the proposal or any competing proposal";

(b) take "reasonable steps to ensure that any conflict (real or perceived) is avoided" until appropriate disclosure has been made; and

(c) obtain the target board's consent prior to divulging any non-public information,

(together, the **Insider Obligations**).

2.3 For the reasons set out below, we do not agree that Affected Shareholders should be expected to comply with these Insider Obligations.

Anomaly at law

2.4 Unlike officers and advisers of a target who are subject to the existing Guidance Note 19 as "insiders", shareholders do not, as a matter of status, occupy a fiduciary relationship to the target, and therefore the law does not impose any fiduciary duties upon them.[1]

2.5 Indeed, to impute Insider Obligations, or any positive obligation in favour of the target, on an Affected Shareholder would be an anomaly at general law, where shareholder duties to a company, in a strict sense, are limited to unpaid amounts on share capital.[2]

2.6 This does not mean shareholder action should be unfettered in a control transaction. We acknowledge other regulatory bodies have, in limited circumstances, sought to impose duties on shareholders in the context of control transactions, such as by preventing substantial holders from resiling from acceptance statements in response to a takeover bid. However, we consider that the Insider Obligations are a more excessive

[1] In *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, Dixon J at 504 noted: "shareholders are not trustees for one another, and, unlike directors, they occupy no fiduciary position and are under no fiduciary duties".

[2] The limited shareholder duties that general law recognises are fundamentally owed to other shareholders, rather than to the company itself (see, eg, *Gambotto v WCP Ltd* (1995) 182 CLR 432 in relation to duties owed by majority to minority shareholders). This is separate to duties that a shareholder may agree to in a contractual sense (e.g., under a shareholders' agreement or a constitution).

encroach on shareholders conduct, and without the same degree of justification from a policy perspective, when compared to these other duties.

Policy basis to impose Insider Obligations

2.7 We understand that the overarching purpose of the Insider Obligations is to mitigate potential conflicts of interest between an "insider" and the target (noting that the obligations in paragraphs 11 to 14 of the Consultation Paper are contained under the sub-heading "addressing potential conflicts of interests").

2.8 However, the Panel's policy justification for extending the Insider Obligations to an Affected Shareholder remains unclear to us. As mentioned above, shareholders do not owe any fiduciary duties to a target, and, generally speaking, are free to act in their own self-interest, regardless of whether any conflicts exist.[3]

2.9 Based on the definition of "insider" in the Consultation Paper, the two aspects that make a shareholder of a target an Affected Shareholder (and thus subject to the Insider Obligations) are the Affected Shareholder:

(a) having a nominee on the board of the target; and

(b) obtaining MNPI through that nominee.

2.10 However, we do not see why these circumstances, whether alone or in combination, should cause a shareholder to be tainted as an "insider" and subject to compliance with the Insider Obligations.

2.11 If the Panel's concern lies in the Affected Shareholder's possession of MNPI, we consider that concern to be already adequately addressed under existing insider trading laws and, if applicable, information sharing agreements between the Affected Shareholder and their nominee. These tools already go to restricting the ability of an Affected Shareholder to deal with their voting shares, or make disclosures of MNPI to a prospective bidder, in the context of a control transaction. We see no need for the Panel to introduce new standards for shareholders with MNPI, which go above and beyond these existing protections.

2.12 Further, it would seem that the possession of <u>any</u> MNPI is sufficient to convert a shareholder into an Affected Shareholder. In our experience, the quality and scope of MNPI that an Affected Shareholder receives from its nominee is often far more limited than the information available to the target board. This access disparity alone is enough to question whether it is appropriate to regulate all "insiders" to the same duty standard.

2.13 Alternatively, if the Panel's concern relates to the potential for the nominee to become conflicted as a result of the Affected Shareholder's involvement in, or knowledge of, a control transaction, we consider that to be the responsibility of the nominee to remedy at a board level, rather than the Affected Shareholder at a shareholder level.[4] In our experience, nominee directors are required to navigate conflict issues often, and are adept at resolving those issues with their board in line with their fiduciary duties. We see no reason to instead place the burden on Affected Shareholders in this instance.

2.14 In addition, the imposition of the Insider Obligations on an Affected Shareholder is not subject to the nominee becoming aware of the relevant approach "which might lead to

[3] See, eg, *North-West Transportation Co v Beatty* (1887) 12 App Cas 589: "It is clearly recognised that shareholders have a proprietary interest in their shares that is similar to proprietary interests in any other property. This [generally] enables shareholders to exercise voting rights attaching to their shares in their own self-interest".

[4] For example, by the nominee being required to make certain disclosures to the board or being excluded from certain board discussions and votes.

a control proposal" – in other words, it is not conditional on the nominee having received any additional information or being in any situation of conflict as compared to other members of the target board. The policy basis underlying paragraphs 11 to 14 of the Consultation Paper therefore seems to be (at least partially) predicated on the assumption that there is necessarily a two-way flow of information between an Affected Shareholder and their nominee, which, in our experience, is often not the case. While a nominee might pass on to their appointing shareholder information in relation to their target obtained in their capacity as a nominee, the shareholder may not pass back to the nominee information obtained in their capacity as a shareholder of the target.

3 Practical impact of Insider Obligations

3.1 The lack of clear policy justification for the imposition of the Insider Obligations on Affected Shareholders is particularly troublesome given the practical impact of doing so on Affected Shareholders and, more broadly, targets with Affected Shareholders on their register.

3.2 Of particular concern is the expectation that Affected Shareholders inform the board of "any approaches that might lead to a control transaction" and in any event, to do so "before entering into any agreement, arrangement or understanding with the proponent of the potential control proposal that might curtail the board's opportunity to consider the proposal or any competing proposal" (**Disclosure Obligations**). This is drafted so broadly that it would seemingly capture almost any approaches received by an Affected Shareholder in respect of their shares, including proposed direct acquisitions of their shares, put/call option arrangements and pre-bid agreements.

3.3 In our experience, it is common for prospective bidders to offer these types of arrangements to target shareholders on condition of strict confidentiality. While it remains unclear what level of disclosure is required to satisfy the Disclosure Obligations, assuming even basic details about the offer must be disclosed to the target board, then the deal impact is potentially severe and inequitable because:

(a) The bidder may be entitled to withdraw the offer, meaning, the Affected Shareholder's ability to treat with the bidder or otherwise freely enter arrangements with the bidder in respect of their shares is eroded.

(b) Shareholders may be less inclined to exercise their rights to appoint a nominee if doing so might impact their ability to deal with their shares in the future.

(c) Most significantly, in the longer-term, prospective bidders may be disincentivised from approaching Affected Shareholders, which may adversely impact not only Affected Shareholders, but all target shareholders as well.

3.4 This final consequence is best illustrated through the following hypothetical scenarios:

(a) Assume a bidder had the option of approaching two shareholders in a target – Shareholder A or Shareholder B – both with a 15% share in the target, but only Shareholder A had a nominee. The incentive created by this Consultation Paper is for the bidder to treat with Shareholder B rather than Shareholder A, who is subject to the Disclosure Obligations. In effect, the Disclosure Obligations makes Shareholder A (and Affected Shareholders generally) less attractive to a bidder which may result in unfair impact if it translates to Affected Shareholders missing out on bidder engagement.

(b) Assume a bidder was weighing up their approach of two potential target companies – Target A and Target B – each with a major shareholder on the register with a 15% share, but only Target A's major shareholder was an Affected Shareholder. All else being equal, the bidder may be more likely to approach Target B's major shareholder, and ultimately Target B itself, to avoid

giving rise to the Disclosure Obligations. This would be unfair not only to Target A's Affected Shareholder, but also to Target A's broader shareholder pool who lose the opportunity to benefit from a control proposal by the bidder.

(c) And, concerningly, these same scenarios could apply even in circumstances where the Affected Shareholder has no meaningful engagement with the bidder. Assume an Affected Shareholder was approached by a bidder in connection with a potential control proposal in relation to the target. But the Affected Shareholder had no interest in what the bidder had to offer, and immediately dismissed the approach. Under the first limb of the Disclosure Obligations (as contained in paragraph 11 of the Consultation Paper), the Affected Shareholder would still be expected to inform the target of the approach given it is an "approach that might lead to a control proposal". We see no reason why this should be the case, and, in particular, why being an Affected Shareholder (as opposed to a "regular" shareholder) would have any bearing here. Ultimately, this will result in bidders being even more reluctant to approach Affected Shareholders (knowing that even an initial approach is enough to trigger the Disclosure Obligations), compounding the unfair impact placed upon Affected Shareholders by the Consultation Paper.

3.5 In each case, we believe that the imposition of the Disclosure Obligations to Affected Shareholders would go to reducing market competitiveness (a key policy principle of the Consultation Paper and the Panel more generally) by curtailing bidder approaches, and would undermine a shareholder's inherent rights to deal with their own shares. Both consequences are undesirable and avoidable if the Panel is minded to refrain from including Affected Shareholders in the definition of "insider".

4 Clarity required in the Insider Obligations

4.1 In any event, but particularly if the Panel is minded to preserve the extension of the definition of "insider" to Affected Shareholders, we consider that the Insider Obligations would benefit from clarification in respect of the following matters:

(a) The Disclosure Obligations are vague as to when disclosure is required. For instance, an "insider" is expected to notify the target of approaches that "might lead to a control proposal, taking into account the likelihood of a control proposal being made". It is unclear to us how an "insider", and in particular an Affected Shareholder, could be positioned to make this assessment.

(b) Similarly unclear is the difference between duties in the Insider Obligations that the Panel "considers" and "expects" insiders should follow. No guidance is provided in the example remedies in paragraph 28 of the Consultation paper, as these are not tied to any particular circumstances. Is the panel more likely to declare unacceptable circumstances in respect of a matter that the Panel "expects" an insider to meet? If so, this should be articulated clearly.

(c) The expectation in paragraph 14 of the Consultation Paper that insiders obtain the consent of the board before they provide any non-public information seems ill-fitted when applied to Affected Shareholders. The Consultation Paper seems to suggest that this confidentiality requirement is justified given that it is already captured by existing law. Footnote 21 of the Consultation Paper (which has been included at the end of paragraph 14) reads: "In any event, insiders owe a duty of confidentiality to the target (see sections 182 to 185 [of the Corporations Act] as applicable)". While this may be true for other "insiders", these sections of the Corporations Act do not apply to shareholders, who also do not owe a duty of confidentiality to companies at general law. A shareholder only owes a target a duty of confidentiality where a shareholder has agreed to that duty in a contractual sense (e.g., under an information sharing agreement or a shareholders' agreement). To the extent that the Panel is suggesting that

Affected Shareholders now also be subject to a duty of confidentiality at general law, this would be a fundamental change of established law with which we do not agree. In any event, footnote 21 should be amended to make it clear that an Affected Shareholder is not subject to the quoted sections of the Corporations Act.

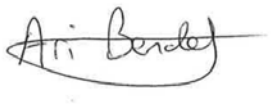
4.2 The uncertainties present in the Insider Obligations as currently expressed are likely to mobilise claims to the Panel. As differently constituted Panels will form their own interpretation of the language and gaps in paragraphs 11 to 14 – we consider that the Panel should seek to pre-emptively provide clarity and predictability for Affected Shareholders.

Arnold Bloch Leibler welcomes the opportunity to provide further submissions and participate in further consultation in respect of the Consultation Paper and any proposed amendments to the Panel's guidance.

Yours sincerely

Arnold Bloch Leibler

Jeremy Leibler
Partner



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27 FEBRUARY 2023

Submission - Guidance Note 19 – Insider participation in control transactions

We refer to the consultation paper entitled "Insider participation in control transactions" dated 14 December 2022 ("**Paper**"). We are pleased to provide the following submissions and commentary on the matters raised in the Paper.

Capitalised terms used but not defined in this document have the meaning given in the Paper.

1 Summary

The revised Guidance Note is a helpful update.

Our specific points are limited. However, they reflect our position that guidance should recognise the fact that each situation may be different.

For example, as outlined in the response to Question 2, the expectations on a CEO as a participating insider will be different to those of a nominee director appointed by a shareholder.

2 Questions

1 Do you agree with the updated definition of participating insider.

Yes.

However, as is developed below, the definition of a participating insider covers everyone from the CEO to a shareholder whose nominee has provided some non-public information to it.

Their respective obligations, and whether or not their actions, or the actions of others in relation to them, should lead to unacceptable circumstances may be different.

2 Do you agree with the guidance provided (in paragraphs 11 to 14) in relation to when an insider should notify the board or any relevant sub-committee of the target of any approaches that might lead to a control proposal?

No.

The obligation of an insider to inform the target board of any approaches will depend on the specific circumstances and there cannot be the same obligation to inform the board in all circumstances. Paragraphs 11 and 12 should reflect that different considerations may apply.

For example, we consider it is impractical to require a nominee of a substantial shareholder (say with 19%) or that substantial shareholder itself to be required to inform the board of an approach from a potential bidder seeking discussions on whether that substantial shareholder would be prepared to sell into a bid or join a bid consortium. We are also of the view that a substantial shareholder should be permitted to enter an arrangement even if that arrangement was to curtail the board's opportunity to consider any proposal or any competing proposal. The disclosure obligations should be those required in connection with substantial shareholder notices.

Requiring disclosure of approaches to a shareholder as a shareholder would limit a shareholder's ability to act in its interests as a shareholder.

There may be an obligation on a board nominee of a major shareholder to make disclosure to the target board as a result of their duties as a director. However, whether such a duty as a director exists involves weighing complex issues of conflicting duties of confidentiality and duties of care and diligence. However, we do not think that a failure of a shareholder or its nominee to make such disclosure is likely to be unacceptable circumstances.

On the other hand, we consider that a CEO or other senior executive or a director in their personal capacity that is approached to join a potential bidder should advise the board of that approach immediately. Because of a CEO's critical role in a company, the risks are greater of adverse consequences to the company, and a potential bidder being preferred, or being seen to be preferred, if disclosure is delayed.

We agree that insiders should obtain the consent of the board before they provide any non-public information obtained from the target.

3 Do you agree that, if all directors are participating insiders, the target should consider appointing at least one independent director to form an independent board committee?

Yes.

4 Is the guidance provided under the heading 'Protocols' useful? Please explain.

In our view, the guidance is consistent with good practice.

5 Is the list of factors that may give rise to unacceptable circumstances useful? Please explain.

Yes.

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

We would reverse the changes made to the regime for provision of information to potential rival bidders in former paragraphs 23-25 (and therefore remove new item 27(f)). Australia has a relaxed position on that subject by comparison to the UK already. To relax it further would be a retrograde step in an area where there is significant potential for preclusive conduct. In particular, a process to ensure independence on decisions of this type (as foreshadowed in item 27(f)) has merit but ignores the subtle pressures that can be brought to bear in situations of this type when insiders are involved in the initial bid.

KING&WOOD MALLESONS
金杜律师事务所

A related point is that the cross-reference to GN7 in footnote 38 is too general. There should be a reference to paragraph 15 of GN7 and footnote 12 of that Guidance Note should cross reference the specific provisions of GN19.

Yours sincerely

Signed Will Heath

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28 February 2022

Takeovers Panel Consultation Paper
Response to revised Guidance Note 19

Introduction

We welcome the Takeovers Panel's (**Panel**) proposal to revise Guidance Note 19 and appreciate the opportunity to comment on the proposed form of the revised guidance note.

Revised Guidance Note 19

General

We support the approach the Panel has adopted in the revised Guidance Note 19. The changes make clear the way the Panel will approach the management of conflicts which we consider to be consistent with how best practice has been applying the existing guidance to the broader circumstances in which these matters now arise.

We make specific comments on two particular matters in the revised guidance below for the Panel's consideration.

Specific comments

1 Paragraph 10(a)

Paragraph 10(a) states, in providing guidance on the scope of the "participating insider" concept, that the description of participation should not include *'an offer by a potential bidder to continue the person's existing equity, compensation or other arrangements with the target or enter into new arrangements on similar terms to the existing arrangements'* (emphasis added).

We believe the Panel should consider whether the phrase 'similar terms' should be replaced with 'commercially equivalent terms', or it should be made clear that is how it will be interpreted. For instance, it may be that a bidder intends to offer a person a commercially equivalent compensation package, but in a different form/structure to their existing arrangement (possibly to harmonise with their existing/usual approach), such that it may not technically be on similar terms. We are of the view the Panel should consider clarifying the scope of the phrase 'similar terms' or using a different expression.

2 Paragraph 17

The revised guidance provides that *'[i]f all directors are participating insiders, companies should consider appointing at least one independent director to form an IBC'.*

We do not take issue with that guidance, because we believe the word *'consider'* makes it clear the Panel recognises the practical challenges an entity may (and perhaps is likely) to face in appointing an independent director.

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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 draft revised 'Guidance Note 19 – Insider Participation in Control Transactions (**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 General comment

As noted in the Consultation Paper, when Guidance Note 19 was introduced in 2007, it was in the context of a significant increase in private equity bids at that time (which had been relatively uncommon prior to then). Not only was the Guidance Note in response to this increase in private equity bids, it also sought to address a number of hypothetical scenarios which might arise in the future, and which may have been of concern.

For example, in addition to dealing with position of a director or member of senior management who has an agreement, arrangement or understanding with the bidder or its associates in relation to the bid, the Guidance Note sought to cover a range of other hypothetical scenarios, such as conflicted advisers or former advisers, former directors etc.

This tended to complicate the definitions of 'insider' and 'participating insider', and to complicate the core principles underlying the guidance, namely, that consideration by the target board and/or senior management of a bid or control proposal should occur without influence from the bidder or any competing bidder, and that provision of the target's confidential information should be under the control of the board, rather than any senior management who may have some relationship with the bidder.

If the Guidance Note is to be revised, we would recommend that the document be simplified as described below, to make the guidance more accessible and useful for market participants

3 Response to specific questions

3.1 Question 1

Do you agree with the updated definition of insider?

The term 'insider' is used in paragraphs 11-14 (obligations on insiders to notify the board if they become aware of an approach made to the company in relation to a control proposal), and in the definition of 'participating insider'. The updated definition of 'insider' is perhaps an improvement, but it could be further substantially simplified to mean "any director or member of senior management of the target". On this point:

- the words in paragraph (a) of the definition of 'insider', "who is in a position to influence the target's consideration of the bid", only introduce uncertainty as to the application of the definition;
- it does not seem necessary to refer to 'advisers' in the definition. Typically, the role of advisers, and their duties in relation to conflicts and information, will be set out in their mandate letters with the target. Our recollection is that advisers were included in the original Guidance Note following one isolated example where an investment bank, who may or may not have had an engagement with the target in relation to certain matters, became a participant in a bidding consortium for the company. However, this would not seem to justify extending the entire guidance to advisers, let alone former advisers; and
- paragraph (b) of the definition of 'insider' refers to persons who are outside of the target company, but who may have access to material non-public information concerning the target. This may or may not be under NDA with the target. If the Revised Guidance Note needs to deal with this category of persons at all, it may be best not to characterize them as 'insiders'. The guidance would also need to consider the basis on which that person has the information, and the permitted uses of the information.

3.2 Question 2

Do you agree with the updated definition of participating insider?

Again, the definition of 'participating insider' could be greatly simplified to mean: 'any director or member of senior management of the target who (a) is themselves the bidder, or a nominee of the bidder; or (b) who has an agreement, arrangement or understanding with the bidder or its associates in relation to the bid'.

Paragraphs 8(a) and 8(b) of the Revised Guidance Note then give a range of examples of such an agreement, arrangement or understanding, while paragraph 10 refers to certain agreements, arrangements or understandings which would not, of themselves, make the director or member of senior management a 'participating insider'.

3.3 Question 3

Do you agree with the guidance provided (in paragraphs 11 to 14) in relation to when an insider should notify the board or any relevant sub-committee of the target of any approaches that might lead to a control proposal?

Generally yes, if 'insider' is defined as any director or member of senior management.

Paragraphs 11 to 14 become unworkable though if, as is currently the case, 'insider' is defined to include major shareholders with nominees on the board, or current or former advisers, or former directors and officers. It is not clear why those persons would be receiving an approach addressed to the target, but in any event, the guidance becomes confused if 'insider' is given too broad a meaning here.

In our view, paragraphs 11 to 14 could simply state that any director or member of senior management who receives an approach to the target in connection with a control proposal should notify the board immediately of that approach.

3.4 Question 4

Do you agree that, if all directors are participating insiders, the target should consider appointing at least one independent director to form an independent board committee?

Prior to addressing this question, we note that paragraph 15 seems to contemplate that there would be an IBC, even where none of the directors is participating insiders. If it is non-director senior management who are 'participating insiders', then an IBC is not necessary. In that scenario, it is also worthwhile noting that the non-director senior management who are 'participating insiders' will have duties under their employment arrangements with the target.

As to the scenario where all directors are participating insiders, we agree that the target should consider appointing at least one independent director to form an IBC. However, while this may be desirable, there will obviously be considerable practical difficulties in finding a truly independent director who will be prepared to go on to the board of the target, without any underlying knowledge of the target's business, operations and affairs, for the sole purpose of responding to a takeover bid or scheme of arrangement.

3.5 Question 5

Is the guidance provided under the heading 'Protocols' useful? Please explain.

Generally yes. We agree with the Panel's non-prescriptive approach in paragraph 20, noting that each situation will be different and will warrant an assessment of all the relevant facts and circumstances. However, it would also be useful in this section to restate the core principles which should inform the drafting of the protocols, namely:

- that consideration by the target board and/or senior management of a bid or control proposal should occur without influence, or the appearance of influence, from a bidder, which requires that participating insiders be excluded from the process; and
- that provision of the target's confidential information should be under the control of the target board (or IBC where there are director participating insiders), rather than any directors or senior management who may have some relationship with the bidder.

Although we note that the protocols set out in paragraph 20 are examples only and are not intended to be prescriptive, the example, in paragraph 26(c) of requiring participating insiders to be advised that they must not provide any "corporate information" (which has an inclusive definition in footnote 26) to "**anyone**" (defined in footnote 27 as "any employee, customer or supplier of the target") "without the express approval of the IBC and following entry into an appropriate confidentiality agreement" is too generally stated.

For example, if a key employee or officer is a participating insider it should generally be the case that they should continue to be able to provide corporate information to customers or suppliers in the ordinary course of business.

The Panel may wish to consider amending footnote 27 to limit the scope of the example provided in paragraph 20(c) (for example, it could amend footnote 27 to read "Which may include (depending on the circumstances), employees, customers or suppliers of the target". Alternatively, the Panel may consider including a new footnote at the end of paragraph 20(c), which states:

"The Panel is not to be taken as suggesting that the mere fact that an officer or employee is a participating insider means that they cannot freely continue to fulfill their duties to the target in the ordinary course of business."

3.6 Question 6

Is the list of factors that may give rise to unacceptable circumstances useful? Please explain.

While the factors listed are marginally helpful, they are only a small sub-set of the factors that may be relevant for the Panel in determining whether the consideration by the target board and senior management of a bid or control proposal has been free of influence from a bidder, and whether the provision of the target's confidential information has affected in some way an effective competition for control of the target.

Our concern is that, by listing just those factors in paragraph 26, it might be argued in the future that the list of relevant factors for a sitting Panel should be determined by reference in some way to this list in paragraph 26. We therefore query the utility of including this list.

If paragraph 26 is to be retained, paragraph 26(g) of the Revised Guidance Note is too broadly stated insofar that it extends to a participating insider "coming to an understanding with a potential bidder without first providing sufficient information to the IBC or the board for it to consider the transaction".

It may well be the case (and indeed is often the case) that a potential bidder will only be prepared to propose a transaction to a target if the bidder had come to some form of understanding (even if not formal or legally binding) with one or more participating insiders in the first place. In such circumstances, it may be impractical or even impossible for a participating insider to provide information to the IBC or the board about a potential transaction *prior* to reaching the understanding.

We think that the Panel should limit the ambit of paragraph 26(g) by replacing the words after "coming to an understanding" with "entering an agreement or arrangement" (noting, of course, that the matters set out in paragraph 26 are non-prescriptive examples of what may constitute unacceptable circumstances and that the Panel will ultimately turn to the particular facts of a case when making an assessment).

3.7 Question 7

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

As stated above, the Guidance Note could be substantially simplified through the amendments referred to above.

The Panel should also consider making the following minor edits to the Revised Guidance Note:

- **Paragraph 20(a) –** for clarity, add "with whom they are involved" to the end of this paragraph;
- **Paragraph 20(b)(ii) –** add "or standing aside" after "notwithstanding such resignation"; and
- **Paragraph 24(e) –** add "or section 636(1)(a)" after "section 602" – relevantly, section 636(1)(a) of the *Corporations Act 2001* (Cth) requires the bidder in a takeover to disclose the identity of the bidder.

Law Council
OF AUSTRALIA

Business Law Section

Submission in response to consultation paper on Guidance Note 19

28 February 2023

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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 19—Insider Participation in Control Transactions (**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 in the Revised Guidance Note.

General comment

3. As noted in the Consultation Paper, when Guidance Note 19 was introduced in 2007, it was in the context of a significant increase in private equity bids at that time (which had been relatively uncommon prior to then). Not only was the Guidance Note in response to this increase in private equity bids, it also sought to address a number of hypothetical scenarios which might arise in the future, and which may have been of concern.

4. For example, in addition to dealing with the position of a director or member of senior management who has an agreement, arrangement or understanding with the bidder or its associates in relation to the bid, the Guidance Note sought to cover a range of other hypothetical scenarios, such as conflicted advisers or former advisers, former directors, etc.

5. This tended to complicate the definitions of 'insider' and 'participating insider', and to complicate the core principles underlying the guidance, namely, that consideration by the target board and/or senior management of a bid or control proposal should occur without influence from the bidder or any competing bidder, and that provision of the target's confidential information should be under the control of the board, rather than any senior management who may have some relationship with the bidder.

6. If the Guidance Note is to be revised, the Committee recommends that the document be simplified as described below, to make the guidance more accessible and useful for market participants.

Response to specific questions

Question 1

Do you agree with the updated definition of insider?

7. The term ‘insider’ is used in paragraphs 11–14 (obligations on insiders to notify the board if they become aware of an approach made to the company in relation to a control proposal), and in the definition of ‘participating insider’. The updated definition of ‘insider’ is perhaps an improvement, but it could be further substantially simplified to mean “any director or senior manager of the target”. On this point:

- The words in paragraph (a) of the definition of ‘insider’, “who is in a position to influence the target’s consideration of the bid”, only introduce uncertainty as to the application of the definition;

- It does not seem necessary to refer to ‘advisers’ in the definition. Typically, the role of advisers, and their duties in relation to conflicts and information, will be set out in their mandate letters with the target. The Committee’s recollection is that advisers were included in the original Guidance Note following one isolated example where an investment bank, who may or may not have had an engagement with the target in relation to certain matters, became a participant in a bidding consortium for the company. However, this would not seem to justify extending the entire guidance to advisers, let alone former advisers; and

- Paragraph (b) of the definition of ‘insider’ refers to persons who are outside of the target company, but who may have access to material non-public information concerning the target. This may or may not be under NDA with the target. If the Revised Guidance Note needs to deal with this category of persons at all, it may be best not to characterize them as ‘insiders’. The guidance would also need to consider the basis on which that person has the information, and the permitted uses of the information.

Question 2

Do you agree with the updated definition of participating insider?

8. Again, the definition of ‘participating insider’ could be simplified to mean: ‘any director or member of senior management of the target who (a) is themselves the bidder; or (b) who has an agreement, arrangement or understanding with the bidder or its associates in relation to the bid’.

9. Paragraphs 8(a) and 8(b) of the Revised Guidance Note then give a range of examples of such an agreement, arrangement or understanding, while paragraph 10 refers to certain agreements, arrangements or understandings which would not, of themselves, make the director or member of senior management a ‘participating insider’.

Question 3

> Do you agree with the guidance provided (in paragraphs 11 to 14) in relation to when an insider should notify the board or any relevant sub-committee of the target of any approaches that might lead to a control proposal?

10. Generally yes, if 'insider' is defined as any director or senior manager.

11. Paragraphs 11 to 14 become unworkable though if, as is currently the case, 'insider' is defined to include major shareholders with nominees on the board, or current or former advisers, or former directors and officers. It is not clear why those persons would be receiving an approach addressed to the target, but in any event, the guidance becomes confused if 'insider' is given too broad a meaning here.

12. In the Committee's view, paragraphs 11 to 14 could simply state that any director or senior manager who receives an approach to the target in connection with a control proposal should notify the board immediately of that approach.

Question 4

> Do you agree that, if all directors are participating insiders, the target should consider appointing at least one independent director to form an independent board committee?

13. Prior to addressing this question, the Committee notes that paragraph 15 seems to contemplate that there would be an independent board committee (**IBC**), even where none of the directors is a participating insider. If it is non-director senior management who are 'participating insiders', then an IBC is not necessary. In that scenario, it is also worthwhile noting that the non-director senior management who are 'participating insiders' will have duties under their employment arrangements with the target.

14. As to the scenario where all directors are participating insiders, the Committee agrees that the target should consider appointing at least one independent director to form an IBC. However, while this may be desirable, there will obviously be considerable practical difficulties in finding a truly independent director who will be prepared to go on to the board of the target, without any underlying knowledge of the target's business, operations and affairs, for the sole purpose of responding to a takeover bid or scheme of arrangement.

15. The Committee considers that the Revised Guidance Note should acknowledge this (perhaps in a footnote at the end of paragraph 17) as a relevant factor that the Panel will take into account in assessing the effect of a lack of independence and whether or not unacceptable circumstances exist.

Question 5

Is the guidance provided under the heading 'Protocols' useful? Please explain.

16. Generally yes. The Committee agrees with the Panel's non-prescriptive approach in paragraph 20, noting that each situation will be different and will warrant an assessment of all the relevant facts and circumstances.

17. It might also be useful in this section to restate the core principles which should inform the drafting of the protocols, namely:

    - that consideration by the target board and/or senior management of a bid or control proposal should occur without influence, or the appearance of influence, from a bidder, which requires that participating insiders be excluded from the process; and

    - that provision of the target's confidential information should be under the control of the target board (or IBC where there are director participating insiders), rather than any directors or senior management who may have some relationship with the bidder.

18. Although the Committee notes that the protocols set out in paragraph 20 are examples only and are not intended to be prescriptive, the Committee considers that the example, in paragraph 26(c) of requiring participating insiders to be advised that they must not provide any "corporate information" (which has an inclusive definition in footnote 26) to "anyone" (defined in footnote 27 as "any employee, customer or supplier of the target") "without the express approval of the IBC and following entry into an appropriate confidentiality agreement" is too generally stated.

19. For example, if a key employee or officer is a participating insider it should generally be the case that they should continue to be able to provide corporate information to customers or suppliers in the ordinary course of business.

20. The Panel may wish to consider amending footnote 27 to limit the scope of the example provided in paragraph 20(c) (for example, it could amend footnote 27 to read "Which may include (depending on the circumstances), employees, customers or suppliers of the target". Alternatively, the Panel may consider including a new footnote at the end of paragraph 20(c), which states:

    > "The Panel is not to be taken as suggesting that the mere fact that an officer or employee is a participating insider means that they cannot freely continue to fulfill their duties to the target in the ordinary course of business."

Question 6

Is the list of factors that may give rise to unacceptable circumstances useful? Please explain.

21. While the factors listed are marginally helpful, they are only a small sub-set of the factors that may be relevant for the Panel in determining whether the consideration by the target board and senior management of a bid or control proposal has been free of influence from a bidder, and whether the provision of the target's confidential information has affected in some way an effective competition for control of the target.

22. The Committee is concerned that, by listing just those factors in paragraph 26, it might be argued in the future that the list of relevant factors for a sitting Panel should be determined by reference in some way to this list in paragraph 26. The Committee therefore queries the utility of including this list.

23. If paragraph 26 is to be retained, the Committee consider that paragraph 26(g) of the Revised Guidance Note is too broadly stated insofar as it extends to a participating insider "coming to an understanding with a potential bidder without first providing sufficient information to the IBC or the board for it to consider the transaction".

24. It may well be the case (and indeed is often the case) that a potential bidder will only be prepared to propose a transaction to a target if the bidder had come to some form of understanding (even if not formal or legally binding) with one or more participating insiders in the first place. In such circumstances, it may be impractical or even impossible for a participating insider to provide information to the IBC or the board about a potential transaction prior to reaching the understanding.

25. The Committee considers that the Panel should limit the ambit of paragraph 26(g) by replacing the words after "coming to an understanding" with "entering an agreement or arrangement" (noting, of course, that the matters set out in paragraph 26 are non-prescriptive examples of what may constitute unacceptable circumstances and that the Panel will ultimately turn to the particular facts of a case when making an assessment).

Question 7

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

26. As stated above, the Committee believes that the Guidance Note could be substantially simplified through the amendments referred to above.

27. The Committee also recommends that the Panel consider making the following minor edits to the Revised Guidance Note:

- **Paragraph 20(a)—**for clarity, add “with whom they are involved” to the end of this paragraph;

- **Paragraph 20(b)(ii)—**add “or standing aside” after “notwithstanding such resignation”; and

- **Paragraph 24(e)—**add “or section 636(1)(a)” after “section 602”—relevantly, section 636(1)(a) of the *Corporations Act 2001* (Cth) requires the bidder in a takeover to disclose the identity of the bidder.

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 of Australia Limited itself is a representative body with its members being:

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

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.

Australian Shareholders' Association

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3 March 2023

Mr Allan Bulman
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By email: takeovers@takeovers.gov.au

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

Rachel Waterhouse
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