Australian Government

Takeovers Panel

Reasons for Decision
Billabong International Limited
[2013] ATP 9

Catchwords:

Decline to make a declaration – break fee – coercion – failure to disclose – efficient, competitive and informed market – funding arrangement – lock-up device – naked no vote – shareholder approval

Corporations Act 2001 (Cth), section 602

Guidance Note 7: Lock-up devices

AMP Shopping Centre Trust 01 [2003] ATP 21, Ausdoc Group Limited [2002] ATP 9, Pinnacle VRB Ltd (No. 8) [2001] ATP 17

Interim order	IO undertaking	Conduct	Declaration	Final order	Undertaking
No	No	Yes	No	No	No

INTRODUCTION

1. The Panel, David Friedlander (sitting President), Richard Hunt and John Story, declined to make a declaration of unacceptable circumstances in relation to the affairs of Billabong International Limited after Billabong and the Altamont Consortium amended certain terms of their agreements**.** The application concerned financing arrangements entered into between Billabong and the Altamont Consortium and their potential to act as lock-up devices.

2. In these reasons, the following definitions apply.

Altamont	Altamont Capital Partners LP
Altamont Consortium	entities advised by Altamont and other entities sub-advised by GSO
Billabong	Billabong International Limited
Bridge Facility Termination Fee	the 20% premium of the principal amount under the Syndicated Facility Agreement, payable if: (a) Billabong did not use commercially reasonable efforts to pursue the long term financing and completed alternative financing by 15 January 2014 or (b) a change of control occurred before 15 January 2014 and the bridge facility was repaid as a result before 31 December 2013
C/O Consortium	Oaktree Capital Management LP and Centerbridge Partners LP, each on behalf of their affiliated funds
Commitment Letter	commitment of long term financing of US$294 million senior secured term loan facilities contained in a

	commitment letter dated 16 July 2013 from Altamont Capital Management, LLC, ACP Burleigh Holdings, LLC and GSO to Billabong
Convertible Tranche	US$40 million tranche of the long term financing, convertible into RPS, subject to Billabong shareholder approval
CT Increased Rate	35% interest rate payable on the Convertible Tranche prior to Billabong shareholder approval
GSO	GSO Capital Partners LP
RPS	redeemable preference shares, to be issued as part of Billabong's long term financing on conversion of the Convertible Tranche
Syndicated Facility Agreement	syndicated facility agreement dated 16 July 2013 between Burleigh Point, Ltd and Altamont Capital Management, LLC and ACP Burleigh Holdings, LLC, FS Investment Corporation and FS Investment Corporation II to provide bridge financing

FACTS

3. Billabong is an ASX listed company (ASX code: BBG).

4. Billabong had received various change of control and restructuring proposals since early 2012 and, during that time, had conducted a public sale/refinancing process. Concurrently, Billabong's financial position had deteriorated and it had announced a series of earnings downgrades.

5. In July 2013, Billabong was in discussions with the C/O Consortium (at the time the holder of the majority of Billabong's debt) regarding a refinancing proposal. Those discussions involved a proposed waiver in connection with financial covenant breaches, including a A$40 million waiver fee if Billabong concluded a transaction with any party other than the C/O Consortium.

6. On 16 July 2013, Billabong announced agreements with the Altamont Consortium, including:

   (a) a US$294 million bridge facility (with a maturity date of 31 December 2013, under the Syndicated Facility Agreement)

   (b) a commitment letter for US$294 million of long term financing to replace the bridge facility, including the Convertible Tranche. Subject to shareholder approval, the Convertible Tranche could be converted into the RPS, which could be converted into ordinary shares

   (c) an exclusivity period to 31 December 2013, during which the parties must use commercially reasonable efforts to pursue the long term financing

   (d) the issue of 84.5 million options (representing 15% of Billabong's share capital once the options are exercised) with a strike price of A$0.50, the issue of some of which were subject to shareholder approval

(e) the sale of Billabong's DaKine business for A$70 million to Altamont and

(f) management and board changes.

7. On 23 July 2013, Billabong announced the completion of the DaKine sale and drawdown of the bridge facility. The proceeds from the sale and drawdown were used to repay Billabong's syndicated debt facilities and working capital.

8. If the RPS were converted and options exercised, the Altamont Consortium would have an interest of up to approximately 40% voting power in Billabong.

9. The bridge facility terms required that, in the event of a change of control of Billabong, the facility be repaid and the Bridge Facility Termination Fee be paid. Change of control was defined in Billabong's Common Terms Deed as control as set out in section 50AA.[1] That section includes a change of control brought about by the acquisition of voting shares.

10. The long term financing terms included mandatory repayment of outstanding debt plus payment of a make-whole premium in the event of a change of control of Billabong. The make-whole premium in the first two years was 10% of the principal amount of the loan plus interest that would have been payable during that two years.[2] The make-whole premium reduces in subsequent years.

11. The Convertible Tranche had an interest rate of 35% per annum until shareholder approval was received for the conversion of the Convertible Tranche into the RPS and for the issue of some of the options. If shareholder approval was received, the interest rate reduced to 12% per annum. The dividend rate on the RPS was 12% per annum.

APPLICATION

12. By application dated 18 July 2013, the C/O Consortium sought a declaration of unacceptable circumstances. The C/O Consortium submitted (among other things) that the Bridge Facility Termination Fee and CT Increased Rate were lock-up devices that were anti-competitive and coercive, so that the acquisition of control over Billabong shares was not taking place in an efficient, competitive and informed market.

Interim orders sought

13. The C/O Consortium sought interim orders including that drawdown under the bridge facility and completion of the DaKine sale be deferred, that the Altamont Consortium be prevented from enforcing exclusivity arrangements or exercising any options pending determination of its application and additional disclosure of the exclusivity arrangements.

14. The President declined to grant interim orders, noting to the parties that drawdown under the bridge facility and completion of the DaKine sale would not constrain the sitting Panel.

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[1] References are to the *Corporations Act 2001* (Cth) unless otherwise stated

[2] Discounted at the US Treasury rate plus 0.5% p.a.

Final orders sought

15. The C/O Consortium sought final orders to the effect that the Bridge Facility Termination Fee be cancelled, the CT Increased Rate be cancelled, Billabong disclose the details of its exclusivity arrangements with the Altamont Consortium and further details of the Bridge Facility Termination Fee, Altamont be prevented from enforcing the exclusivity arrangements, the options issued to the Altamont Consortium be cancelled and Billabong be prevented from issuing further options.

16. The C/O Consortium revised its request for final orders after submissions, which included a copy of the Commitment Letter, were received. It removed the requested order for additional disclosure and sought an additional order that the make-whole premium (or any similar term) in the long term financing be cancelled.

DISCUSSION

Background

17. The bridge facility and long term financing were negotiated in the context of Billabong's urgent need for funds, and the fact that the company had conducted a public sale/refinancing process over more than 12 months.

18. Altamont submitted that "*absent the timing constraints raised by [Billabong's] distressed financial situation*" it would not have provided the bridge facility and instead would have pursued the long term financing, subject to shareholder approval. It further submitted that "*without the protections the CO Consortium is challenging, the Altamont Consortium would not have provided the Bridge Facility or committed to enter into the [long term financing] on the terms set out in the Commitment Letter.*"

19. In general, financing arrangements are a matter for a company's board, and routinely contain features that are triggered by a change of control. However, financing arrangements that have the effect of locking up a company or deterring rival control proposals directly raise the question as to the acceptability of the circumstances.

Control transaction

20. The bridge facility and long term financing are connected and incorporated the conversion of the Convertible Tranche into the RPS and the issue of options that would constitute an interest in Billabong of up to 40.49%.[3]

21. Altamont submitted that if the RPS were converted and the options exercised its maximum interest in Billabong would be up to 29% and that GSO's maximum interest would be 12%.

22. The application raised the question of whether Altamont and GSO are associates. Altamont and GSO submitted that they had different interests and separate

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[3] As stated in Billabong's announcement of 16 July 2013, assuming the RPS convert into ordinary shares. Various submissions referred to slightly different figures

decision-making processes, despite the fact that they were parties to multi-party agreements with joint rights and obligations. We did not need to reach a conclusion on this issue.

23. Altamont alone would have obtained up to a 29% equity interest in Billabong. But in any event the transactions involved the acquisition of shares. This is sufficient for us to consider the lock-up effect of the Bridge Facility Termination Fee, the make-whole premium and the CT Increased Rate. We leave open the question of whether, absent any acquisition of shares, a lock-up effect is a matter for the Panel.

Bridge Facility Termination Fee

24. Guidance Note 7 *Lock-up Devices* states that a lock-up device is "*an arrangement that encourages or facilitates a control transaction and potentially hinders another actual or potential control transaction*".[4] "*Control transaction*" specifically includes a shareholder approved transaction under item 7 of s611.[5] GN7 also defines a break fee as "*consideration however payable by a target if specified events occur which prevent a bid from proceeding or cause it to fail*".[6]

25. The Bridge Facility Termination Fee encouraged or facilitated this control transaction and was payable if, among other things, there was a change of control of Billabong. We consider that the trigger of a "change of control" potentially hinders another actual or potential control transaction.

26. That a lock-up device is found in a financing document and not, say, a bid implementation agreement, does not alter its effect. As GN7 states, the "*Panel looks at the substance of the lock-up device over its form*."[7]

27. ASIC submitted that while GN7 specifically refers to a bid "*the underlying principles supporting the policy should be construed broadly to include circumstances such as these where there is no formal bid.*" We agree. We consider the Bridge Facility Termination Fee to be a lock-up device, specifically a break fee.

28. In *Ausdoc Group Limited*[8] the Panel stated that "*the ultimate criterion [is] whether any particular fee is reasonable in amount or anti-competitive in effect*".[9] We agree, noting that the public sale/refinancing process Billabong had undertaken over more than 12 months is a relevant factor.

29. The Bridge Facility Termination Fee of approximately A$65 million represented 54% of Billabong's equity value prior to announcement of the transactions with the Altamont Consortium. While Billabong's share price increased substantially after announcement of the transactions, the fee clearly exceeded 1% of equity value, below which a break fee will generally not be unacceptable, as set out in GN7.[10]

[4] At [5]
[5] Footnote 3
[6] Para [5]. GN7 uses 'bid' as a convenient reference to any control transaction: para [1]
[7] At [8]
[8] [2002] ATP 9
[9] At [39]
[10] At [9]

30. The C/O Consortium submitted that the Bridge Facility Termination Fee was in fact deterring rival proposals and, as evidence, pointed out that a condition of its proposals to Billabong after 16 July 2013 was, effectively, that the fee be cancelled.

31. ASIC submitted that a "*$65 million penalty payment arising in the event of a change of control would serve to deter any reasonable third party seeking to table an alternative proposal*".

32. Altamont submitted that the Bridge Facility Termination Fee was different to a break fee because the Altamont Consortium had provided the bridge facility funds upfront, in contrast to a takeover or scheme of arrangement.

33. We understand the point Altamont makes, but consider that the magnitude of the Bridge Facility Termination Fee was likely to deter rival proposals for control of Billabong, so as to inhibit the acquisition of voting shares taking place in an efficient, competitive and informed market, and was unacceptable.

Make-whole premium

34. Under the long term financing, a change of control of Billabong would have triggered mandatory repayment of the full loan and payment of a make-whole premium. There were other triggers too.

35. The make-whole premium was not disclosed by Billabong in its 16 July 2013 announcement. We think it should have been.[11]

36. The C/O Consortium submitted that the make-whole premium was "*an equivalent break fee of an amount which may materially exceed the 20% premium [the Bridge Facility Termination Fee]…[up to] approximately $107 million*".

37. Altamont submitted that *"it is standard market practice for a prepayment premium to be payable in the context of financing arrangements. The purpose of a prepayment premium is to compensate a lender for early repayment and loss of interest, rather than any control purpose."*[12]

38. We consider that the change of control trigger for the make-whole premium in the long term financing (as distinct from the other triggers in this case), as with the Bridge Facility Termination Fee, created a situation where a substantial financial penalty would be imposed on Billabong if there was a change of control, which was likely to deter rival control proposals, and was unacceptable.

CT Increased Rate

39. The CT Increased Rate of 35% was payable if the long term financing had been finalised but Billabong shareholder approval for the conversion of the Convertible Tranche into RPS and the issue of some of the options had not been received. If shareholder approval had been received the interest rate was to be 12%.

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[11] See *AMP Shopping Centre Trust 01* [2003] ATP 21 at [59], where the Panel found there had been inadequate disclosure of pre-emptive rights in co-ownership agreements for five shopping centres and acquisitions had been made "*on the understanding that ART was capable (commercially) of being taken over.*"
[12] Prepayment in this context means repayment

40. GN7 states that the Panel will look at the effect or likely effect of the lock-up device on "*shareholders and whether they may be substantially coerced into accepting the bid*".[13] "*Accepting the bid*" is analogous for this purpose to shareholders approving a control transaction under item 7 of s611.

41. Billabong submitted that the CT Increased Rate "*reflect[s] the cost of the incremental capital, and is heavily subordinated in the debt capital structure.*"

42. Altamont submitted that the CT Increased Rate "*does no more than fairly compensate [Altamont] for the loss of 'equity upside' on the overall package*". It also submitted that it was "*highly unlikely that [Billabong] would enter into the [long term financing] prior to [Billabong] Shareholder Approval being sought*" and "*the period (if any) during which the 35% interest rate will be payable on the Convertible Tranche would be limited to the case where [Billabong] Shareholder Approval is not obtained.*"

43. The issue for us is whether the magnitude of the CT Increased Rate or the increment between the interest rates constitutes a financial penalty to Billabong, if shareholder approval is not received, such that it is likely to substantially coerce shareholders into approving the conversion of the Convertible Tranche into RPS and the issue of some of the options.

44. The CT Increased Rate is a "naked no vote" break fee because it is, in effect, a payment triggered by the absence of shareholder approval. GN7 states that "naked no vote" break fees may be unacceptable because the trigger is unreasonable.[14] Where a company is in financial distress it is likely that shareholders may feel commercial pressure to approve a transaction, however, the Panel has stated that it is a matter of degree as to whether the magnitude of the pressure applied by the specific terms of the transaction is unacceptable. [15]

45. We consider the incremental interest cost of approximately A$10 million per year[16] here to be likely to substantially coerce shareholders into approving the conversion of the Convertible Tranche into RPS and the issue of some of the options to the Altamont Consortium.

Exclusivity obligation

46. In summary, the exclusivity obligation in the Commitment Letter required Billabong not to solicit alternative financing arrangements. The C/O Consortium submitted that the clause may also have acted as a "no-talk" lock-up device that was not subject to a fiduciary out.

47. Altamont submitted that the Commitment Letter did not "*contain any 'no-talk', 'no due diligence' or 'matching right' restrictions at all*" and was "*identical to the no-shop*

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[13] At [7(b)]
[14] At [9]
[15] *Ausdoc Group Limited* at [45]. The Panel expressed a similar view in *Pinnacle VRB Ltd (No. 8)* [2001] ATP 17 at [75]: "*Indeed it would be improper for matters requiring shareholder approval to go to members with such a consequence, as they then would be voting with the threat of damages to the company if they failed to approve.*"
[16] (35% - 12%) x US$40 million = US$9.2 million incremental interest per year

restriction considered by the Panel (and found to be acceptable) in Ross Human Directions Limited."[17]

48. We do not consider the exclusivity obligation unacceptable.

Independent expert report

49. The Commitment Letter required Billabong to use its best efforts to "*obtain an independent expert report…opining that the issuances covered by Shareholder Approval are fair and reasonable to the company's shareholders.*"

50. ASIC submitted that this obligation "*appears inconsistent with the proper legislative function of an IER…as it is seemingly suggestive of a requirement to acquire an IER with an opinion favourable to acquiring member approval.*" In rebuttal submissions Billabong submitted that it "*does not understand that to be the operation of the provision*" and that its obligation was not to "*seek a particular outcome from the expert*".

51. We think that the wording of the obligation on Billabong should have been clearer and should not have been open to the interpretation ASIC gave it. We accept that Billabong intended to obtain an independent expert report in the ordinary manner. In any event, the revised Commitment Letter modified the relevant clause to address this issue.

Revised agreements between Billabong and the Altamont Consortium

52. The Panel advised Billabong and the Altamont Consortium that it was minded to make a declaration of unacceptable circumstances in relation to the Bridge Facility Termination Fee, the change of control trigger for the make-whole premium and the CT Increased Rate.

53. In response, Billabong and the Altamont Consortium requested that the Panel defer making its decision to allow time for them to re-negotiate their agreements to amend or remove the offending terms. We agreed to defer our decision and required the revised terms to be sent to all parties for comment.

54. We reviewed the revised terms provided by Billabong and the Altamont Consortium and the comments of the C/O Consortium and ASIC on those terms. We advised the parties that if Billabong and the Altamont Consortium executed agreements on those terms we would not make a declaration of unacceptable circumstances, on the bases that:

    (a) while the A$6 million[18] revised Bridge Facility Termination Fee is above 1% of Billabong's equity value Altamont submitted that it was slightly less than 1% of its enterprise value. GN7 states that enterprise value can be a more appropriate basis for assessment of a break fee when a company is highly

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[17] [2010] ATP 8

[18] The financing arrangements included reimbursement of the lenders' expenses independent of the Bridge Facility Termination Fee. We consider this to be a common financing term and linked to the up-front provision of bridge financing to Billabong

geared,[19] as is the case with Billabong, and in these circumstances we accepted Altamont's submission

(b) the triggers for payment of the revised Bridge Facility Termination Fee do not relate to a change of control of Billabong

(c) the make-whole premium in the event of a change of control has been reduced to 1% of the principal amount and

(d) there is no financial penalty for Billabong if shareholders fail to approve the issue of RPS to the Altamont Consortium.

55. In conjunction with the changes to address the unacceptable terms, Billabong and the Altamont Consortium made revisions to their agreements that altered the financial effect of the transactions between them. We make no comment on those revisions; they are for the parties involved.

56. On 21 August 2013, Billabong and the Altamont Consortium announced revised agreements that, among other things:

(a) reduced the Bridge Facility Termination Fee to A$6 million and altered its triggers so it was not payable in the event of a change of control of Billabong

(b) replaced the make-whole premium with a payment of 101% of the principal amount in the event of a change of control of Billabong and

(c) removed the CT Increased Rate.

DECISION

57. Given the amendments to the agreements between Billabong and the Altamont Consortium, we declined to make a declaration and are satisfied that it is not against the public interest to do so. We had regard to the matters in s657A(3).

Orders

58. Given that we made no declaration of unacceptable circumstances, we make no final orders, including as to costs.

David Friedlander
President of the sitting Panel
Decision dated 21 August 2013
Reasons published 28 August 2013

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[19] See footnote 7

Advisers

Party	Advisers
Altamont	Baker & McKenzie
Billabong	Allens
C/O Consortium	Gilbert + Tobin
GSO	Norton Rose Fulbright