



Law Council
OF AUSTRALIA

Business Law Section

Mr Allan Bulman
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Takeovers Panel
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24 October 2016

Dear Allan,

Submission on proposed changes to Guidance Note 12 – Frustrating Action

This is a submission by the Corporations Committee of the Business Law Section of the Law Council of Australia (the Committee) in response to the Consultation Paper issued by the Takeovers Panel (the Panel) on 14 September 2016 in relation to the revision of Guidance Note 12 on Frustrating Action.

The Committee's responses are as follows:

1. Is there any need to amend the existing guidance?

The reason given in the Consultation Paper for the changes is that a number of market participants have expressed the view that the GN in its current form does not adequately explain the risk attached to the various considerations making frustrating action unacceptable, and that the position of target directors is said to have become more difficult of late because of the trend for bidders to include a long, complex and restrictive list of bid conditions.

While we agree that the existing guidance could benefit from some amendment to remove considerations which do not advance the frustrating action policy, the Committee did not think that bid conditions are any more long, complex and restrictive now than 10-15 years ago, when it was more common to have conditions such as those requiring the target to give due diligence confirmations or take actions assisting the bidder.

That said, we are in favour of clarifying the Guidance Note in a number of respects described below.

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2. Is the revised list of 'considerations when assessing unacceptable circumstances' appropriate (paragraph 12)?

The Committee's view is that the list in paragraph 12 is generally appropriate, although more could still be done to explain the relevance of particular considerations, and the weight which would be given to them. For example, paragraph 12(d) lists as a relevant consideration whether the frustrating action is undertaken by the target in ordinary course of business, without going on to say that, if the action was undertaken in the ordinary course of business, it will generally not be unacceptable. Likewise, paragraph 12(c) lists as a relevant consideration whether there is already a competing proposal. Presumably this is suggesting that if there is already a competing superior proposal, so that the bid is not reasonably likely to be successful, then the frustrating action is not likely to give rise to unacceptable circumstances. But again, this is not clear.

Another concern is with the overlap which is created by having a separate list of 'considerations when assessing unacceptable circumstances' in paragraph 12; and a separate list of 'circumstances tending against unacceptable circumstances', which itself includes a catch all of circumstances where it is 'otherwise unreasonable' to find unacceptable circumstances. It would seem that this drafting could be condensed into a single list, with an explanation of the relevance of the various factors.

3. "Genuine opportunity"

There are different views within the Committee as to whether 'no genuine opportunity' should be merely a 'relevant consideration' in deciding whether unacceptable circumstances exist, or whether the guidance should make it clear that, if the bid really does not give shareholders a genuine opportunity to dispose of their shares, then the frustrating action policy does not apply.

Those that say it should only be a 'relevant consideration' argue that there is rarely a clear binary distinction between a bid or potential bid which gives a genuine opportunity to shareholders to sell their shares, and one that does not, and that more often it will require an assessment of all relevant circumstances, and balancing of competing principles and policy objectives (they offer an illustration of this in paragraph (a) below). Proponents of this view are also concerned the existence of a "safe harbour" may encourage some target boards to conclude a potential bid does not give rise to a "genuine opportunity" when that is not appropriate and, as a result, undertake action that denies their shareholders their right to decide the outcome of the bid.

Those that say the frustrating action policy should not apply at all say that there are clear circumstances where there is no genuine opportunity for shareholders to sell their shares, and if that is the case, then there is nothing to frustrate, and there is no policy basis for target boards being subjected to an extra layer of restriction, on top of their existing statutory and fiduciary duties, in conducting the business of the company. It is also argued that target boards need clear guidance in this situation, and that having no genuine opportunity as just another 'relevant consideration' does not provide this, thereby forcing target boards to take a

conservative approach in practice to avoid the risk of a declaration of unacceptable circumstances.

Set out below are some of the different views in respect of each of the three categories of bids referred to in paragraphs 20(a), (b) and (c):

- (a) Actions which trigger a condition of a bid or potential bid which cannot be implemented because of a condition or structural or other feature

One view within the Committee is that, if the bid or potential bid truly cannot be implemented (which requires that there be something more than just strong grounds to believe it won't be successful), then there is no 'genuine potential bid', and an action which triggers a condition of such a 'bid' should be carved out from the definition of 'frustrating action'. Such bids should not come under 'considerations tending against unacceptable circumstances'. If the bid is simply not capable of being implemented (for example, because it is made without a reasonable basis as to funding, or because it is subject to a condition that clearly will not be satisfied) there is nothing to frustrate.

The opposing view is that a bid should not always be regarded as one that "cannot be implemented or completed" simply because, at a particular time, it includes a condition requiring the target to take some action which it is not required to take, and which the target has declined to fulfil. For example, a bidder that has not had the opportunity to conduct due diligence on a target may wish to retain the benefit of a bid condition requiring the target to provide certain confirmations at least until after it has had a reasonable opportunity to review the target's statement even if the target has already made it clear it will not provide confirmations satisfying the terms of its condition. During this period there remains the possibility that the target may change its position or that the bidder may waive the condition once the target has prepared its target's statement. Proponents of this view argue that, in these circumstances, it is very likely the bid will remain a genuine bid whose outcome should be decided on its merits by shareholders rather than target directors even though it is subject to a condition that is strictly incapable of satisfaction.

- (b) Actions which trigger a condition of a bid, where there are reasonable grounds to expect that the bid will not be successful

Given that there will be uncertainty as to what amounts to reasonable grounds to expect that the bid will not be successful, the general view within the Committee is that an action which triggers a condition of such a bid should not automatically be carved out from the definition of 'frustrating action'. Such an action may be acceptable (i.e. not constitute unacceptable circumstances) if there are reasonable grounds to believe that the bid will not ultimately be successful, but it will depend on all of the relevant circumstances. This seems to be covered by paragraph 12(a) of the revised draft in any event.

- (c) Actions which trigger a condition of a bid, or potential bid, which is expressed to be subject to a target board recommendation

One view within the Committee is that bids or potential bids which are expressed to be subject to a target board recommendation should not enliven the frustrating action policy at all (i.e. rather than regarding an action which triggers a condition under such a bid or potential bid as a 'frustrating action', but then saying it may not amount to unacceptable circumstances, the action should not constitute a 'frustrating action' in the first place). This has clearly been the position for some time in relation to potential bids which contemplate a scheme transaction structure (example 3 in paragraph 7 of the existing Guidance Note 12)¹.

Where this issue most often arises is in the common situation where a potential acquirer submits a confidential non-binding indicative offer letter to a company. Almost invariably, the letter will state that the proposal, as well as being indicative and non-binding, is subject to the target board unanimously recommending the offer and to the target board providing due diligence. It will also usually state that the proposal is conditional on the target board entering into a binding implementation agreement containing, amongst other things, exclusivity provisions and a break fee.

The proponents of this view argue that such letters should not enliven the frustrating action policy. The arguments put forward by those who support this view include:

- It is relatively easy for a potential acquirer to submit a non-binding indicative offer letter, where the indicative offer is subject to due diligence and a target board recommendation. The impact on the target is far greater if that sort of letter enlivens the frustrating action policy.
- The target board should not be bound by the frustrating action policy simply because there is a hypothetical chance that the party making the approach will bid on a hostile basis, particularly when they have said that they will only bid if the target board recommends the bid. In this situation, there is no 'genuine opportunity' at this stage for shareholders to dispose of their shares.
- Often the target board will not know whether the party making the approach is willing or able to make a hostile bid. If the potential acquirer wants the frustrating action policy to apply, it should make it clear in the letter that, while it would like to have a target board recommendation, its willingness to proceed is not dependent on it.
- If the potential bid is subject to the target board recommending the transaction, then the bid cannot be frustrated if the target board decides not to recommend it, but to instead take some other action which may trigger a condition of the potential bid.

¹ Example 2 in paragraph 7 of the existing Guidance Note 12 states that an action that triggers a 'condition' in a potential bid may not give rise to unacceptable circumstances if the bidder indicated that it would proceed only if the bid was recommended and the directors have rejected the approach.

- Target boards require clarity in this situation. Making the fact that the bid is expressed to be subject to a target board recommendation a 'relevant consideration' as to whether an action will constitute unacceptable circumstances does not provide that clarity.
- Even without the frustrating action policy applying, in those circumstances the target directors are bound to comply with their statutory and fiduciary duties in determining to take any action which may lead to the possible bid not being made. It is not correct to say, therefore, that there are no other restrictions on the target board in these circumstances.
- It is not clear why a scheme proposal cannot be frustrated, but a non-binding indicative takeover bid proposal which is subject to the target board recommending the bid should attract the frustrating action policy.

The opposing view is that a potential acquirer which has submitted such a non-binding indicative offer letter may not have completely ruled out a hostile bid, and until the potential acquirer does so, the target board should be subject to the frustrating action policy restricting its ability to take actions which may trigger conditions of the possible bid. The arguments put forward by those who support this view include:

- If a bidder has not completely ruled out a hostile bid, an approach in these terms will normally involve a "genuine potential bid" that should initially attract the frustrating action policy in the normal way.
- If the frustrating action policy were not to apply in these circumstances, a bidder would have no meaningful remedy if the target board were to undertake what would otherwise be frustrating action. But this action may nevertheless be sufficient to preclude the bidder proceeding with the hostile bid it has foreshadowed.
- Imposing restrictions on the target in these circumstances should not be unduly burdensome. If the target ultimately declines to recommend the bid, the bidder will need to clarify whether it is prepared to waive its requirement and proceed with a hostile bid if it wishes the frustrating action policy to continue to apply. If it does not do so, the restrictions will only have applied for a relatively short period. And if it does, it is clearly appropriate they should have applied and should continue to do so.

4. "Otherwise unreasonable" to consider the frustrating action as giving rise to unacceptable circumstances - a desirable policy shift (or clarification)? Are the circumstances in paragraph 21 of GN 12 appropriate?

In relation to sub-paragraph 21(d), the Committee would suggest deleting example 3, as this really seems to be an example of a bid where there is no genuine opportunity for shareholders to dispose of their shares.

In relation to sub-paragraph 21(e), the words "or has varied the terms of the bid, such as increasing the bid price, but has not waived the condition or the breach" have been added to what is in paragraph 11(f) of the existing Guidance Note 12 (although there is a reference to variation of bid terms in footnote 15, which

explains what is a reasonable time for the purposes of paragraph 11(f)). This was a change which the Panel proposed in its January 2014 consultation paper (the proposed new paragraph 11(g)), but which the Panel ultimately decided to drop in favour of including footnote 15.

We think that sub-paragraph 21(e) of the revised draft should revert to the wording in paragraph 11 and footnote 15 of the existing guidance. The mere fact that a bidder has varied the terms of the bid, even by increasing the price, should not result in the frustrating action policy ceasing to apply. It would depend on the circumstances, including the nature of the condition. This is already covered in the footnote 15 in the existing guidance.

5. Is further guidance required on when it is unacceptable for a target to seek alternatives (subparagraphs 14(b) and 21(d), example 2)?

The Committee did not think that further guidance was required on this.

7. Other issues

(a) Can an action that does not trigger a condition in a bid or proposed bid still constitute a 'frustrating action' for the purposes of the policy?

While the definition of 'frustrating action' in paragraph 5 of the existing guidance is not expressly limited to actions which would trigger a bid condition, paragraphs 6 and 7 are all about actions which would trigger bid conditions, and the need for a bidder to make it clear what the proposed bid conditions are. This helps the reader understand that, while the definition refers to actions by reason of which a bid or potential bid may be withdrawn, in practice the way this will be determined is by reference to the bid conditions. The conclusion is that there would need to be a very unusual set of circumstances where an action which did not trigger a bid condition or proposed bid condition would constitute a 'frustrating action'.

The revised draft guidance seems to move away from this position. The existing paragraphs 6 and 7 have been removed, and there is now no reference to bid conditions at all until towards the end of page 3, where it states that 'typically, the policy applies to an action that triggers a condition of a bid or a potential bid'. We think this is unhelpful, because market participants reading the guidance don't know until they get to the end of page 3 that, in the vast majority of cases, whether the policy will apply will depend on whether the action breached a bid condition or not. It also seems that by making this change the Panel is trying to reserve to itself greater flexibility to regard an action as a frustrating action, even when the action does not trigger a condition of a bid or potential bid.

While we understand the Panel's desire to preserve flexibility, we think that the existing paragraphs 6 and 7 should be re-instated. Also, if the Panel is trying to widen the scope of actions which may be frustrating actions even if they don't trigger a bid condition, it should say so and should give some examples of what it is concerned about. For example, we assume that actions such as those taken by the target board in *Babcock & Brown Communities Group* [2008] ATP 25 at [29]-[36] and *Gondwana Resources Limited* [2014] ATP 9 at [31] are not 'frustrating

actions' as defined, even though they may reduce the likelihood of a bid or a potential bid being made in the future.²

In relation to market bids, the revised draft should also make it clear that an action which may allow the bid to be withdrawn under section 652C is a frustrating action (like an action which triggers a bid condition of an off-market bid). We understood this to be the intent of footnote 1 of the existing guidance, which is repeated in the revised draft, but this is now unclear following the Panel's decision in *Freshtel Holdings Limited* [2016] ATP 15.

(b) Where the target offers target shareholders a choice

We note that the 3 examples in paragraph 15 of the draft are now located under the heading 'Considerations tending against unacceptable circumstances', whereas in the existing guidance they appear under the heading 'Not unacceptable circumstances'.

In our view, the revised draft should make it clear that an action which has been approved by target shareholders in general meeting, or which is conditional on target shareholder approval, does not amount to unacceptable circumstances under the frustrating action policy. Again, it is not the action which has frustrated the bid, but the fact that the target shareholders in general meeting have voted to approve the action over accepting the bid. We think that this is necessary so that a target board has a clear 'safe harbour' for taking the action.

The Committee would be pleased to discuss this submission if that is helpful. Please contact the Chair of the Committee, Rebecca Maslen-Stannage, on 02 9225 5500 if you would like to do so.

Yours sincerely,



Teresa Dyson, Chair
Business Law Section

² One member of the Committee was of the view that, given ASIC's current position that bid consideration should not be reduced for the value of franking credits attached to a dividend paid by the target, the payment of a significant unheralded non-ordinary course franked dividend by the target, without the consent of the bidder, should be regarded as being a frustrating action, even in an unconditional off-market bid or in an on-market bid (i.e. so no bid condition is being triggered). The view of other members of the Committee however is that this would effectively amount to law reform, in that it adds to the events in section 652C entitling a bidder to withdraw an on-market bid. On either view, it would seem desirable to have clarity on whether or not payment of such a dividend is a frustrating action.