Ashurst Australia
8 May 2012

ashurst

Takeovers Legal Update

In this update:

- Break fees and financial assistance
- Unacceptable proposals to take a company outside Chapter 6
- Judicial review challenge withdrawn as Panel gets its way
- Panel finalises updated guidance on takeover documents
- Provision to entrench board in financing agreement not unacceptable

Break fees and financial assistance

In brief

- A recent English court decision treats a break fee as unlawful financial assistance.
- If followed in Australia, the decision may increase uncertainty as to the lawfulness of at least some break fees.

In the recent English High Court decision of *ParOs Plc v Worldlink Group Plc* a break fee was held to amount to unlawful financial assistance.

The break fee was set out in Heads of Terms concerning a possible reverse takeover of Worldink by ParOs, an AIM listed shell company. If discussions ended due to Worldlink refusing to proceed, Worldlink agreed to bear ParOs's costs at the rate of £12,500 per week between signing and re-registering Worldlink as a private company (to which the prohibition against financial assistance did not apply), with a cap of £150,000.

Although a post transaction value of £20 million had been assumed by proposed investors, Worldlink had very limited liquid assets. The judge considered that the break fee amounted to financial assistance under the terms of the UK legislation because it would materially reduce the net assets of Worldlink, given they were negative at the time. It was financial assistance because it would "smooth the path" toward the acquisition of shares. (His Honour also noted that it was not clear that a break fee is always financial assistance, referring to dicta suggesting that in some circumstances it may be an "inducement" rather than "assistance".)

Ultimately, the Heads of Terms were varied to provide for the acquisition of assets rather than shares (meaning that the prohibition against financial assistance did not apply) and the Court found that the fact that it contravened the prohibition when given did not make it unenforceable.

Despite the widespread use of break fees in Australia, unresolved questions remain as to whether, in certain circumstances, break fees may be unlawful, including on grounds that they involve unlawful financial assistance.

Some commentators have argued that break fees cannot give rise to financial assistance because the fee is only payable if the transaction does not proceed, and accordingly the company's financial resources will only be diminished where there is *no* acquisition of shares. The *ParOs* decision implicitly rejects that argument, taking the view that a break fee "smooths the path" for an acquisition because it allows an acquirer to incur costs to progress an acquisition secure in the knowledge that it will be reimbursed if the transaction fails.

Although the Australian provisions concerning financial assistance are quite different from those considered in *ParOs*, they were originally based on the UK provisions and UK case law as to what constitutes "financial assistance" may still be persuasive. Even if the *ParOs* approach is adopted, a break fee will not amount to unlawful financial assistance in Australia unless it materially prejudices the interests of the company or its shareholders or the company's ability to pay its creditors. However, a competing bidder could seek an injunction, triggering a reversal of onus under the *Corporations Act* that requires the court to assume material prejudice unless the contrary is proven. Determining the level at which a break fee results in material prejudice may be difficult. Accordingly, if *ParOs* is followed in Australia, it may increase uncertainty as to the lawfulness of some break fees, at least.

Authors

Marie McDonald
Partner
Melbourne
T: +61 3 9679 3264
E: marie.mcdonald@ashurst.com

Bruce Dyer
Partner
Melbourne
T: +61 3 9679 3413
E: bruce.dyer@ashurst.com

Unacceptable proposals to take a company outside Chapter 6

In brief

A strategy designed to remove a company from the ambit of Chapter 6 may be unacceptable.

The takeovers regime in Chapter 6 of the *Corporations Act* only applies to an unlisted company if it has more than 50 members. If the number of members is only a little more than 50, a potential acquirer may be tempted to avoid the constraints and costs imposed by Chapter 6 by seeking to reduce the number of members. The Takeovers Panel's decision in *Careers Australia Group Limited* suggests that anyone taking that path will need to tread carefully.

Background

In July 2011, Cirrus Business Investments Limited entered into a convertible note deed with unlisted public company, Careers Australia Group Limited, pursuant to which Careers Australia agreed to issue convertible notes (with a face value of 66 cents each) that on conversion would give Cirrus up to 45.29% of the expanded voting shares in Careers Australia. Careers Australia obtained shareholder approval for the purposes of the 20% takeovers threshold to allow Cirrus to acquire a relevant interest of up to 45.29% in Careers Australia on conversion of the convertible notes. This was necessary because Careers Australia had more than 50 members (88 at the time of the application).

In November 2011, Cirrus offered an "exit opportunity" to certain Careers Australia shareholders at 66 cents per share, conditional on enough shareholders entering into option deeds to allow the total number of shareholders to be reduced below 50. Cirrus submitted that its purpose was to facilitate an exit for minor shareholders who had been unable to sell more shares under a buy-back (at 66 cents per share) in August 2011.

Decision

The Panel had concerns about Cirrus's proposal but declined to make a declaration of unacceptable circumstances after Cirrus undertook to limit the number of options it exercised so that Careers Australia would still have 62 shareholders (hence Chapter 6 would still apply).

The Panel considered that unacceptable circumstances may arise where there is a plan or proposal designed to cause a company to be taken outside the ambit of Chapter 6. However the Panel also accepted that there may be circumstances where the removal of a company from the ambit of Chapter 6 is not unacceptable, for example, where this is an ancillary or coincidental consequence of another act.

The Panel suggested it might not have had concerns if Cirrus's offer had been made to all shareholders. It was also inclined to think that the shareholder approval to exercise the convertible notes up to 45.29% (which was only required if Chapter 6 applied) gave shareholders a legitimate expectation that any further acquisition would occur pursuant to a takeover bid or as otherwise authorised under Chapter 6.

Discussion

It is unclear exactly when a proposal to take a company outside Chapter 6 will be unacceptable. A narrow reading of the Panel's reasons in *Careers Australia* suggests that may only be the case if the means used to disapply Chapter 6 are inconsistent with its purposes. The Panel's references to Cirrus's offer not being extended to all shareholders and being inconsistent with expectations generated by the shareholder approval support this interpretation. However, another reading might suggest that any plan *designed* to take a company out of Chapter 6 will be unacceptable. The Panel did not need to reach a final view since it accepted undertakings making it unnecessary to decide whether to make a declaration.

In our view, the narrow reading is a better approach. There should be no objection where an acquirer's only intention is to buy a stake below the 20% threshold. If those acquisitions reduce the number of members below 50, it is difficult to see why that result should be unacceptable if intended but not otherwise. The Panel usually focuses on the effect of action, rather than its purpose, and is not as well equipped as a court to determine purposes.

Authors

Garry Besson
Partner
Sydney
T: +61 2 9258 6268
E: garry.besson@ashurst.com

Megan Trethowan
Lawyer
Melbourne
T: +61 3 9679 3533
E: megan.trethowan@ashurst.com

Judicial review challenge withdrawn as Panel gets its way

In brief

Judicial review challenges to the Panel's decision to accept undertakings have been discontinued following performance of the undertakings.

In July last year the Takeovers Panel accepted undertakings, in lieu of making a declaration of unacceptable circumstances, after finding that various parties were associated in relation to two ASX listed companies, Bentley Capital and Queste.

In a novel twist, the parties who gave the undertakings (and one other) sought judicial review of the Panel's decision to accept the undertakings they had offered. This occurred after differences arose as to the interpretation of the undertakings.

Our April 2012 *Takeovers Legal Update* discussed the Federal Court's refusal of an extension that would have allowed the Panel to resolve the impasse by making a declaration.

It appears now, however, that the Panel has finally got what it wanted.

The undertakings required one of the parties to convene a meeting of Bentley seeking item 7 shareholder approval for the acquisition of certain Bentley shares. This resolution was approved on 4 April 2012, meaning that a divestment undertaking, which would otherwise have applied, did not take effect. The judicial review challenges were later discontinued.

On the basis of the publicly available documents, the judicial review challenges did not appear to have strong prospects, but the Panel will no doubt be pleased that this long running saga is now over.

Authors

Nick Terry
Practice Leader
Sydney
T: +61 2 9258 6122
E: nick.terry@ashurst.com

Claire Hannon
Senior Associate
Melbourne
T: +61 3 9679 3495
E: claire.hannon@ashurst.com

Panel finalises updated guidance on takeover documents

In brief

- The new guidance on takeover documents is largely unchanged from the draft issued in December 2011.
- ASIC's submissions provide some interesting insights as to its views.

The Takeovers Panel has released an updated Guidance Note 18, renamed *Takeover Documents*, which broadens the application of the Panel guidance and provides further detail as to the information required in takeover disclosures.

The final version of the updated guidance is largely unchanged from the draft released late last year (discussed in our December 2011 *Takeovers Legal Update*). ASIC was the only party that made submissions on the draft.

The main changes to the draft are described below, together with noteworthy comments from ASIC's submissions.

Recognition of the utility of the pre-announcement premium

In its submission, ASIC observed that bid prices are often compared to the target's share price as at the date immediately before the announcement of an offer and suggested that the utility of this could be noted. In response, the Panel has added an acknowledgment that such a comparison can be useful for shareholders "because the pre-announcement price is less likely to be influenced by the bid." However, the Guidance Note continues to provide (as discussed in our December 2011 *Takeovers Legal Update*) that statements of premia may constitute unacceptable circumstances unless prices as at the most recent practicable date are included.

Valuations to support directors' recommendations

ASIC's submission took issue with the unqualified statement in the draft guidance that target directors do not need to value the target's shares to make a recommendation. ASIC submitted that in certain situations it will often be appropriate for directors to provide shareholders with an expert's valuation rather than simply presenting financial information. ASIC gave as examples of cases where an expert's valuation may be required where the target has "no earnings history or short term revenue prospects" or where the equity or enterprise values in the accounts may not correlate with the target's share price. In response, the Panel has added a footnote stating that guidance as to the value of the target is usually required and that it may be desirable or necessary to get expert advice in certain cases, such as if there is no earnings history.

While expert's valuations can provide useful insight in cases where financial accounts may not tell the full story, we caution against directors relying solely on an expert's valuation in formulating their recommendation. In our experience, directors will need to carefully consider both financial and qualitative aspects of a bid on a case by case basis and take into account the particular characteristics of the target. Directors should also consider the principles in the Panel's Guidance Note 22 *Recommendations and Undervalue Statements* when giving guidance or making a recommendation to shareholders.

Comment

Our other comments in our December 2011 *Takeovers Legal Update* remain relevant. In particular, the new Guidance Note 18 does not address the more controversial areas of disclosure of forecasts or the use of concise expert's reports. In our view, including guidance as to the Panel's position on these issues would have been helpful.

Authors

Bill Koeck
Partner
Sydney
T: +61 2 9258 5727
E: bill.koeck@ashurst.com

Brady Weissel
Lawyer
Sydney
T: +61 2 9258 5775
E: brady.weissel@ashurst.com

Provision to entrench board in financing agreement not unacceptable

In brief

- Provisions in a financing agreement that gave rise to a "review event" or an "event of default" on a change to the board did not give rise to unacceptable circumstances.
- Exercise of the lender's rights in response to any board spill resolution was not a control transaction in the Chapter 6 sense.

The Takeovers Panel declined to conduct proceedings on an application from Payce Industries Pty Ltd regarding RCL Group Limited.

Payce, LTHC Pty Ltd and Lanox Pty Ltd (who together held approximately 18.5% of the shares in RCL) requisitioned a general meeting to remove two directors of RCL and appoint two new directors. RCL's primary lender advised that changes to the board constituted a "review event" under a financing agreement and might trigger an "event of default".

Payce submitted that the clauses in the financing agreement entrenched the incumbent directors and acted as a "poison pill", because no bidder would acquire an influential shareholding in RCL if it could not vote freely on resolutions regarding composition of the board.

The Panel considered that without more, the exercise of a lender's contractual rights on a change to RCL's board of directors did not constitute a control transaction for the purposes of Chapter 6. The Panel considered that the clauses in the financing agreement did not affect the voting power of shareholders because the lender could not determine the outcome of any vote. Rather, the lender had contractual rights that were activated upon a change to the composition of the board.

The Panel noted that there could be circumstances where such clauses could be unacceptable, for example, if the clauses were a "device" in an agreement between a company and a substantial shareholder/lender and were designed to affect control, but that was not the case in relation to RCL.

The Panel distinguished the decision in *AMP Shopping Centre Trust 02*. In that matter, certain pre-emptive rights gave a related party a right to purchase "irreplaceable and uniquely valuable" assets, in the event of a change of shareholding control. Here, the ultimate right of the primary lender on a change in composition of the board was the right to require payment of any outstanding funds owed to it under the facility – a right generally consistent with the rights of all lenders.

As the Panel noted, it is common for control transactions to be conditional on consent or waiver by a lender. If the Panel had accepted the arguments put forward by Payce, it would have created significant uncertainty as to how change of control clauses would operate in future.

Authors

Jason Lambeth
Partner
Sydney
T: +61 2 9258 6480
E: jason.lambeth@ashurst.com

Sev Thomassian
Lawyer
Sydney
T: +61 2 9258 6496
E: sev.thomassian@ashurst.com

Abu Dhabi
Suite 101, Tower C2
Al Bateen Towers
Bainunah (34th) Street
Al Bateen
PO Box 93529
Abu Dhabi
United Arab Emirates
T: +971 (0)2 406 7200
F: +971 (0)2 406 7250

Adelaide
Level 4
151 Pirie Street
Adelaide SA 5000
Australia
T: +61 8 8112 1000
F: +61 8 8112 1099

Brisbane
Level 38, Riverside Centre
123 Eagle Street
Brisbane QLD 4000
Australia
T: +61 7 3259 7000
F: +61 7 3259 7111

Brussels
Avenue Louise 489
1050 Brussels
Belgium
T: +32 (0)2 626 1900
F: +32 (0)2 626 1901

Canberra
Level 11
12 Moore Street
Canberra ACT 2601
Australia
T: +61 2 6234 4000
F: +61 2 6234 4111

Dubai
Level 5, Gate Precinct Building 3
Dubai International
Financial Centre
PO Box 119974
Dubai
United Arab Emirates
T: +971 (0)4 365 2000
F: +971 (0)4 365 2050

Frankfurt
OpernTurm
Bockenheimer Landstraße 2-4
60306 Frankfurt am Main
Germany
T: +49 (0)69 97 11 26
F: +49 (0)69 97 20 52 20

Hong Kong
16/F ICBC Tower, Citibank Plaza
3 Garden Road
Central
Hong Kong
T: +852 2846 8989
F: +852 2868 0898

Jakarta (Associated Office)
Oentoeng Suria & Partners
Level 37, Equity Tower
Sudirman Centre
Business District
JI. Jend. Sudirman Kav. 52-53
Jakarta Selatan 12190
Indonesia
T: +62 21 2996 9200
F: +62 21 2903 5360

London
Broadwalk House
5 Appold Street
London EC2A 2HA
UK
T: +44 (0)20 7638 1111
F: +44 (0)20 7638 1112

Madrid
Alcalá, 44
28014 Madrid
Spain
T: +34 91 364 9800
F: +34 91 364 9801/02

Melbourne
Level 26
181 William Street
Melbourne VIC 3000
Australia
T: +61 3 9679 3000
F: +61 3 9679 3111

Milan
Via Sant'Orsola, 3
20123 Milan
Italy
T: +39 02 85 42 31
F: +39 02 85 42 34 44

Munich
Prinzregentenstraße 18
80538 Munich
Germany
T: +49 (0)89 24 44 21 100
F: +49 (0)89 24 44 21 101

New York
Times Square Tower
7 Times Square
New York, NY 10036
USA
T: +1 212 205 7000
F: +1 212 205 7020

Paris
18, square Edouard VII
75009 Paris
France
T: +33 (0)1 53 53 53 53
F: +33 (0)1 53 53 53 54

Perth
Level 32, Exchange Plaza
2 The Esplanade
Perth WA 6000
Australia
T: +61 8 9366 8000
F: +61 8 9366 8111

Port Moresby
Level 4, Mogoru Moto Building
Champion Parade
PO Box 850
Port Moresby
Papua New Guinea
T: +675 309 2000
F: +675 309 2099

Rome
Via Sistina, 4
00187 Rome
Italy
T: +39 06 42 10 21
F: +39 06 42 10 22 22

Shanghai
Suite 3408-10
CITIC Square
1168 Nanjing Road West
Shanghai 200041
PRC
T: +86 21 6263 1888
F: +86 21 6263 1999

Singapore
55 Market Street
#07-01
Singapore 048941
T: +65 6221 2214
F: +65 6221 5484

Stockholm
Jakobsgatan 6
Box 7124
SE-103 87 Stockholm
Sweden
T: +46 (0)8 407 24 00
F: +46 (0)8 407 24 40

Sydney
Level 36, Grosvenor Place
225 George Street
Sydney NSW 2000
Australia
T: +61 2 9258 6000
F: +61 2 9258 6999

Tokyo
Shiroyama Trust Tower
30th Floor
4-3-1 Toranomon, Minato-Ku
Tokyo 105-6030
Japan
T: +81 3 5405 6200
F: +81 3 5405 6222

Washington DC
1875 K Street NW
Washington, DC 20006
USA
T: +1 202 912 8000
F: +1 202 912 8050

This publication is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions. For more information please contact us at aus.marketing@ashurst.com.

Ashurst Australia (ABN 75 304 286 095) is a general partnership constituted under the laws of the Australian Capital Territory carrying on practice under the name "Ashurst" under licence from Ashurst LLP, a limited liability partnership registered in England and Wales. Further details about the Ashurst group can be found at www.ashurst.com.

© Ashurst Australia 2012. No part of this publication may be reproduced by any process without prior written permission from Ashurst. Enquiries may be emailed to aus.marketing@ashurst.com. Ref: 652194582.01   08 May 2012