



HERBERT
SMITH
FREEHILLS



TAKEOVERS IN AUSTRALIA

LEGAL GUIDE

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TAKEOVERS IN AUSTRALIA

ABOUT HERBERT SMITH FREEHILLS

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ABOUT THIS BOOKLET

This booklet is intended as a general guide to making, or responding to, a takeover bid in Australia.

This booklet, by necessity, only summarises the main features of the law and practice relating to takeover bids. Accordingly, many aspects of the law and practice are not fully described. Obviously, this booklet should not be relied on as a substitute for obtaining specific advice before determining a course of action.

This booklet was updated in January 2016.

1 INTRODUCTION

The acquisition of control of publicly held companies in Australia may occur in various ways. The most common ways are by 'takeover bid' and by 'scheme of arrangement'.

In general terms, a **takeover bid** involves an acquisition undertaken by making offers to shareholders of the target company. Once sufficient shares have been acquired, control of the target will pass to the bidder, who will then be able to appoint new directors and control the company's operations.

A **scheme of arrangement**, on the other hand, is a shareholder-approved transaction which becomes binding on all shareholders once it is approved by the court. It is a transaction that is driven by the target company so that, unlike a takeover bid, it can only be undertaken on a friendly basis.

Where the takeover leads to a combination of two businesses of comparable size, it is commonly referred to as a **merger** if it is an agreed or recommended transaction. A merger often proceeds without a premium for control flowing from one party to the other, whereas under a takeover, a premium for control is usually paid to target company shareholders.

This booklet is concerned mainly with takeover bids under Chapter 6 of the Commonwealth *Corporations Act 2001* (Corporations Act).

2 LEGISLATIVE FRAMEWORK

In Australia, takeovers are governed by a number of different and overlapping pieces of legislation. This section discusses the legislation most commonly encountered. Other specific industry legislation can be relevant—for example, laws governing banking, media, insurance and trustee companies.

2.1 CORPORATIONS ACT

The Corporations Act is the main legislation governing takeover bids in Australia. It is intended to ensure that takeover bids occur in an orderly and competitive fashion and that shareholders and directors of the target have sufficient time and information to assess the bid and all shareholders have equal opportunities to participate in benefits arising under the bid.

The Australian Securities and Investments Commission (ASIC) also has extensive discretionary powers to modify, or to exempt parties from compliance with, certain provisions of the takeover rules in the Corporations Act in specific cases. These powers are frequently exercised when strict compliance with the law would lead to unnecessary costs or be contrary to the intention of the legislation.

When do the takeover provisions apply?

The key prohibition in the legislation applies where there is:

- an acquisition of control over issued voting shares in a listed company, or in an unlisted company that has more than 50 shareholders; and
- that acquisition results in the number of shares controlled by one person or his or her associates increasing:
 - from 20% or less to more than 20%; or
 - from a starting point that is above 20% and below 90%.

A contravention of the rule is serious and may lead to penalties and the divestment of shares acquired in contravention.

CASE STUDY — MEANING OF 'CONTROL'

In *TVW Enterprises v Queensland Press*, a person held 14.9% of shares in the Herald & Weekly Times Ltd and also had a pre-emptive right over a further 14.9% of shares held by another person. It was decided that the pre-emptive right gave 'control' over the shares, so that a purchase after the pre-emptive right was exercised would not breach the 20% rule. The purchaser already had 'control' over 28.9%.

To whom do the takeover provisions apply?

The provisions apply to acquisitions in Australian incorporated companies with more than 50 members. They do not apply to a company merely because it has operations in Australia or is listed in Australia.

The rules also apply to acquisitions in listed managed investment schemes (which are typically unit trusts which own real estate). This is achieved by equating features of a listed managed investment scheme with a listed company. This avoids the need to repeat the takeover provisions specifically for listed managed investment schemes.

Takeovers of listed trusts can also raise difficult issues relating to collateral benefits, particularly if it is proposed that a payment will be made to an outgoing manager. In those cases, it may be necessary to seek unitholder approval, or ASIC relief, to allow the payment to be made.

2.2 FOREIGN ACQUISITIONS AND TAKEOVERS ACT

The Commonwealth *Foreign Acquisitions and Takeovers Act 1975 (FATA)* may be relevant if the bidder is a foreign person.

In general terms, the FATA requires that the Australian Treasurer (acting through the Foreign Investment Review Board (**FIRB**)) be notified in advance of a proposed acquisition:

- by a single foreign person (together with its associates) of 20% or more of the securities or votes (including potential votes or rights to securities pursuant to an option) of an Australian corporation (a 'substantial interest') with total assets or issued securities valued at more than A\$252 million¹ (a higher threshold of A\$1,094 million² applies to direct acquisitions by prescribed non-government investors including Chilean, Japanese, Korean, United States and New Zealand companies in non-sensitive sectors); and
- by a group of separate foreign persons (together with their respective associates) of 40% or more of the securities or votes (including potential votes or rights to shares pursuant to an option) of such an Australian corporation.

Actions which the Australian Treasurer must be notified of are referred to as 'notifiable actions' and include agreements to make proposed acquisitions.

The FATA gives the Treasurer power to prohibit a proposed acquisition by foreign persons of securities in an Australian corporation (or a foreign corporation that holds relevant Australian assets or entities) whose total assets or issued securities value exceed A\$252 million (a higher threshold of A\$1,094 million applies to acquisitions by prescribed non-government investors including Chilean, Japanese, Korean, United States and New Zealand companies in non-sensitive sectors), where:

- the proposal would result in a change in control;
- the resultant control would be foreign; and
- the foreign control would be contrary to Australia's national interest.

Actions in respect of which the Treasurer has such powers are referred to as 'significant actions'. A person is taken to 'control' an entity if, in the case of an acquisition of an interest in securities:

- the person (with its associates) is in a position to determine the policy of the entity or business;
- the person holds a substantial interest in the entity; or
- is one of two or more persons (together with their respective associates) who holds 40% or more of the securities or votes (including potential votes or rights to shares pursuant to an option).

1 This figure of A\$252 million and all other references in this section to A\$252 million applies from 1 January 2015 to 31 December 2015 and is subject to annual indexation.

2 This figure of A\$1,094 million and all other references in this section to A\$1,094 million applies from 1 January 2015 to 31 December 2015 and is subject to annual indexation.

A person will not be taken to 'control' an entity if the Treasurer is satisfied that in the circumstances, the person together with their associates are not in a position to determine the policy of the entity.

The Treasurer can also make divestment orders where a significant action has already been implemented without prior approval.

A 'foreign person' under the amended FATA includes a foreign government. However, generally all direct investment by foreign governments, their agencies (for example, state-owned enterprises and sovereign wealth funds) and entities in which a foreign government has a substantial interest or in which more than one foreign government collectively have an aggregate substantial interest of 40%, irrespective of size, must be notified to FIRB for review regardless of the value of the investment.

CASE STUDY — FIRB — 'NATIONAL INTEREST'

OZ Minerals owned the Prominent Hill mining operations, located within the Woomera prohibited area in South Australia. A Chinese state-owned enterprise, China Minmetals, sought to acquire OZ Minerals under a recommended transaction. Foreign investment approval was declined on the basis that it was contrary to the national interest, as the acquisition would have given the acquirer access to sensitive security areas. However, a subsequent transaction, which excluded Prominent Hill, was approved.

Note that FIRB often wishes to consult with a target company and other relevant regulatory bodies (such as the ACCC) prior to giving approval. This consultation process

must be managed to avoid premature disclosure of the proposed transaction.

The FATA also contains important provisions, which impose different thresholds and obligations, in respect of acquisitions of:

- Australian land and companies whose Australian land assets comprise more than 50% of the value of their total assets (the rules in relation to whether an action is a significant action or a notifiable action (including threshold tests), exemptions, offences flowing from breaching the rules and application fees differ for each type of land);
- agribusinesses and companies whose agricultural land assets comprise more than 50% of the value of their total assets (different threshold tests for whether an action is a significant action or a notifiable action apply and for example will require approval if the value of agricultural land exceeds A\$15 million (except for certain exempt investors));
- businesses in sensitive sectors, which include media, telecommunications, transport, defence and military related industries and the extraction of uranium and plutonium or the operation of nuclear facilities (lower thresholds for qualification as a notifiable action and/or significant action may apply); and
- portfolio investments in the media sector of 5% or more (all foreign investors must obtain approval to make investments of at least 5% or more in an Australian media business, regardless of the value of the investment).

2.3 COMPETITION IMPLICATIONS

The competition implications of Australian mergers and acquisitions are dealt with in the Commonwealth *Competition and Consumer Act 2010* (the **CCA**), which is

administered by the Australian Competition & Consumer Commission (**ACCC**).

The CCA prohibits anti-competitive mergers and acquisitions. The relevant test is whether the transaction would have the effect, or be likely to have the effect, of substantially lessening competition in a market in Australia, or in a State, Territory or region of Australia.

There can be no clear definition of what is a 'substantial' effect without a close consideration of the facts in a particular situation. Generally, the ACCC takes the view that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger will substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices. Factors which are relevant to this assessment include post-merger market concentration, barriers to entry and expansion, actual and potential import competition and the availability of substitutes.

There is no compulsory pre-merger or pre-acquisition notification under the CCA. However, the ACCC encourages parties to notify the ACCC well in advance of completing a merger or acquisition where both of the following apply:

- the products of the merger parties are either substitutes or complements; and
- the merged firm will have a post-merger market share of greater than 20% in a relevant market.

This is a low threshold. However, the ACCC considers that, where a merger or acquisition meets the above recommended notification threshold, it could potentially give rise to an Australian competition law issue.

Where there is a potential concern, the ACCC is often asked to provide an informal clearance. If, following a review, the ACCC determines that the merger or acquisition is not likely to contravene the CCA, it will provide a 'no objection' letter. While such a letter is not binding on the ACCC, past practice shows that it gives a high degree of regulatory comfort.

A merger party may also make an application to the ACCC for formal clearance on the basis that the merger or acquisition will not contravene the CCA. If granted, this will provide the merging parties with a binding clearance decision and legal protection from court action under the CCA. The formal merger clearance process was introduced in 2007 but has not been used to date.

The Australian Competition Tribunal has power to formally authorise mergers and acquisitions that would otherwise breach the CCA. The Tribunal can only authorise a merger or acquisition if it is satisfied that the benefits to the public outweigh the anti-competitive effects.

Authorisation involves a public process under which interested parties have the ability to make submissions and intervene. It is rarely used, but may be appropriate in matters where there is a real risk of a lessening of competition along with significant benefits to the public.

In December 2013, the Australian Government announced a review of Australia's competition laws and policy. The Final Report was released in March 2015. The review panel recommended that the formal clearance and merger authorisation processes be combined into a single process, with the ACCC as the initial decision-maker. In November 2015, the Government announced its support for this recommendation.

3 PREPARING FOR A TAKEOVER

3.1 ESTABLISH A TEAM

It is important to be well prepared before making a takeover bid. The bidder should establish a working group comprising relevant company executives and external advisers. The exact make-up of the group will depend on the transaction proposed, but should include senior finance, operational and legal executives from the company. The external members should be briefed about the company's current position and long-term strategy.

3.2 IDENTIFY COMMERCIAL OBJECTIVES

The commercial objective for the company needs to be articulated. In planning an acquisition, the company needs to consider the value of the target company and its assets and whether the benefits hoped to be achieved can best be obtained by making a bid or a scheme of arrangement or by proposing some other type of transaction, such as a shareholder-approved placement or an asset purchase.

The same analysis can assist in responding to a takeover bid as it may identify that the bidder may be seeking only a particular asset or outcome.

3.3 DUE DILIGENCE

The target company and its assets should be thoroughly investigated by the bidder and its advisers.

Possible sources of information

In a hostile bid, information about the target may be difficult to obtain. Some information can be obtained from searches of public

records. This should indicate whether there are any defensive provisions in the target's constitution or in terms of issue of securities, details of existing substantial holdings and details of any recent capital raisings. Share registers are also available for inspection.

Internal due diligence

In addition, a bidder must exercise diligence in relation to its own affairs before embarking on a takeover. This includes ensuring that it has sufficient finances to pay acceptances and all incidental costs, such as legal and advisory fees. It is also necessary to ensure that all public statements it makes in connection with the bid are not misleading or deceptive, as the Corporations Act may impose civil and criminal liability on persons who make such statements.

3.4 TAX

The tax impact of the bid on the bidder and on shareholders in the target should be thought through. If tax consolidation is important, 100% of issued securities (including convertible securities) should be acquired.

3.5 PRE-BID DISCUSSIONS

A bidder may discuss plans with the target company in the hope of achieving a friendly bid recommended by the target's directors. This may lead to more information being obtained, but, in that case, the bidder must be careful to ensure that any confidentiality arrangements it enters into with the target company allow it to disclose material information in its bid documents.

Insider trading prohibitions may also inhibit the bidder's ability to acquire shares on-market.

Discussions may also be undertaken with major shareholders to gauge the price level at which a bid may be successful. However, any agreement that a major shareholder would accept a bid or sell its shares may be illegal if the bidder would, as a result of such agreement, breach the general 20% limit.

3.6 STAKE-BUILDING

Pre-bid acquisitions

Before launching a bid, it is lawful (subject to the applicability of FATA, the CCA and any other relevant industry legislation) to acquire a toehold of up to 20% of the issued voting shares in the target. This may enable acquisitions at lower pre-bid prices and may deter others from buying into the company as rivals. It also gives standing to challenge the actions of the target's directors if necessary.

However, there are disadvantages of acquiring such an interest, including raising market prices, compulsory disclosure to the target and relevant securities exchange once interests in 5% or more of voting shares in the target have been acquired (see section 8.1 of this booklet) and becoming 'uncovered' by an ownership tracing notice (see section 8.3 of this booklet).

Pre-acceptance arrangements

Apart from a firm purchase of shares, it is also possible to take an option over shares from, or to enter into a 'pre-acceptance' arrangement with, a key shareholder, up to

the 20% limit. This may deter others from making a bid, even if the agreement is conditional on no higher unmatched rival bid emerging.

Minimum bid price rule

The price paid (or agreed to be paid) for shares during the four months before an offer is made will set a floor for the consideration required under the offer.

Rules against escalators and collateral benefits

Agreements with shareholders in the target need to be carefully drafted in light of rules in the Corporations Act relating to 'escalator agreements' and 'collateral benefits'.

An 'escalator agreement' is an agreement where the bidder buys shares and undertakes to the seller to top up the purchase price if it makes a bid at a higher price subsequently. These agreements are void if made within six months of a bid.

During the offer period, a bidder or its associates must not give a benefit to a person, which is not offered to all holders of securities in the bid class, and which is likely to induce the person or an associate to accept the offer or to dispose of securities. These are referred to as 'collateral benefits'.

CASE STUDY — PRE-BID AGREEMENTS

In *Pasminco v Savage*, Pasminco agreed to buy 17% of shares in Savage from three institutional holders. The agreement required Pasminco to announce a takeover bid within two days and to complete the purchase within three months. The shareholders had the right to terminate the agreement by accepting Pasminco's formal offer or if a higher bid was made which was not matched by Pasminco. The court decided this agreement was lawful, even though the shareholder retained a flexibility to accept a higher offer made by Pasminco or another person. It was not an 'escalator'.

3.7 ANNOUNCING THE BID

The timing of the announcement can be important. The bidder may gain a tactical advantage if the takeover is announced shortly after the release of results by the target company (thereby limiting the target's range of responses) or at a time when the target will have difficulty in responding (for instance, when its chief executive or chairperson is absent).

Once a bid is announced, the bidder must send out the offers within two months.

Under Australian Securities Exchange (ASX) Listing Rules, announcement of the bid also prevents the target company from making a new placement of shares for three months without shareholder approval.

3.8 DEFENSIVE CONSIDERATIONS

The launch of a bid will focus attention on the bidder. This may be from the target seeking ways of defending itself by criticising the bidder or from other predators interested in acquiring the merged company. The bidder will need to consider possible avenues of attack and ensure its house is in order.

3.9 AGREED BIDS

One advantage of reaching agreement for a friendly transaction is that the bidder may get the benefit of a takeover bid implementation agreement. This would typically include an undertaking that the bid will be recommended (in the absence of a superior proposal).

It is also common in a recommended transaction for the bidder and the target to enter into deal protection mechanisms (see section 3.10 below).

3.10 DEAL PROTECTION MECHANISMS

As mentioned in section 3.9, it is common in a recommended transaction for the bidder and the target to enter into deal protection mechanisms including exclusivity and break fee arrangements.

Care needs to be taken in structuring deal protection devices so as to not create a material disincentive to the prospect of the emergence of a rival bid as the Panel may consider those deal protection mechanisms unacceptable.

Break fee arrangements

Break fees are common in recommended bids in Australia.

Typically, a break fee is an agreed amount (generally not exceeding 1% of the deal value is considered acceptable by the Panel) that becomes payable if certain specified events occur that prevent the takeover from proceeding (such as a change of recommendation or rival bid emerging).

Exclusivity arrangements

The parties may also agree to exclusivity arrangement such as:

- 'no shop' or 'no talk' agreements, under which the target agrees not to solicit rival proposals from third parties or not to negotiate with potential rival bidders; and
- notification and matching rights, under which the target agrees to notify the bidder if it receives an unsolicited proposal from a rival bidder, and not to recommend that proposal unless and until it has given the initial bidder a short period to match or better that proposal.

4 TAKEOVER BID V SCHEME OF ARRANGEMENT

An initial question before proceeding with any change of control transaction is whether to conduct the transaction as a scheme of arrangement or a takeover bid. Several factors relevant to this decision are outlined in the table below. For more information on schemes of arrangement, see section 10.6 of this booklet or contact Herbert Smith Freehills for a copy of our guide to *Schemes of Arrangement in Australia*.

SCHEME	TAKEOVER
KEY FEATURES	
<ul style="list-style-type: none"> ◦ Must obtain target shareholder and then court approval. ◦ Process is driven by the target. ◦ Can only be used in friendly deals. 	<ul style="list-style-type: none"> ◦ Only requires acceptances by shareholders. ◦ Process is driven by the bidder. ◦ Can be used in friendly or hostile deals.
AN ALL OR NOTHING TRANSACTION?	
<ul style="list-style-type: none"> ◦ Yes. If the scheme is approved by target shareholders and the court, the bidder will acquire all of the shares in the target. 	<ul style="list-style-type: none"> ◦ Not necessarily. The bidder can obtain full ownership of the target if it acquires $\geq 90\%$ of the target shares. However, 90% minimum acceptance conditions can be (and usually are) waived, thus creating a risk for the bidder of acquiring less than 90% of the target shares.
APPROVAL THRESHOLD TO ACQUIRE 100% OF THE TARGET	
<ul style="list-style-type: none"> ◦ 75% by value of shares voted and 50% by number of shareholders voting for each class of target shareholders present and voting at the scheme meeting(s). ◦ Having a 75% approval threshold (as opposed to a 90% threshold in a takeover) does not necessarily mean a scheme is easier to effect. The class voting system, the ability of the court to discount or disregard votes on the grounds of extraneous interests, and the impact of a low voter turnout can make a scheme easier to block. 	<ul style="list-style-type: none"> ◦ The bidder can compulsorily acquire any outstanding shares in the target if it has acquired $\geq 90\%$ of the target shares and $\geq 75\%$ of the shares that the bidder offered to acquire.

SCHEME

TAKEOVER

ADVANTAGES OF THE BIDDER HOLDING A PRE-BID STAKE

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|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ Can deter third parties from launching rival proposals. ◦ However, a pre-bid stake cannot count towards the shareholder approval threshold. This means a pre-bid stake reduces the pool of eligible voters. | <ul style="list-style-type: none"> ◦ Can deter third parties from launching rival proposals. ◦ A pre-bid stake can count towards the 90% compulsory acquisition threshold. |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

PROHIBITED CONDITIONS

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|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ Fewer prohibited conditions. ◦ However, the court usually requires that any conditions in the bidder's control must be satisfied or waived before the final court hearing. | <ul style="list-style-type: none"> ◦ Maximum acceptance conditions. ◦ Conditions depending on the bidder's opinion or events within the bidder's control. |
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FLEXIBILITY TO VARY THE TERMS OF THE OFFER

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|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ Any variation after the shareholder meeting(s) have been convened may require court consent and the shareholder meeting(s) to be postponed to give shareholders additional time to consider the variation. | <ul style="list-style-type: none"> ◦ The bidder can vary the terms of the takeover to increase the offer price or extend the offer period at virtually any time. |
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TIMETABLE

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ As the courts are closed from mid-late December until the start of February, if there is a preference to complete a transaction during this period, this may be a reason for preferring a takeover. ◦ Usually three to four months to effect. | <ul style="list-style-type: none"> ◦ Generally speaking, the decision to proceed by way of either scheme or takeover will ordinarily not have a material difference on the overall timetable to completion. ◦ Usually three to four months to reach compulsory acquisition. |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

INDEPENDENT EXPERT'S REPORT

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|----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ Effectively mandatory. | <ul style="list-style-type: none"> ◦ Only mandatory if the bidder's voting power in the target is $\geq 30\%$ or if the bidder and target have a common director. |
|----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

COURT INVOLVEMENT

- | | |
|------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ Court approval of a scheme is required and the court supervises all aspects of the scheme. | <ul style="list-style-type: none"> ◦ The court is very unlikely to get involved during a takeover bid. |
|------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|

SCHEME

TAKEOVER

TAKEOVERS PANEL INVOLVEMENT

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|------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ The Takeovers Panel is generally reluctant to get involved in a scheme once the court process has commenced. | <ul style="list-style-type: none"> ◦ The Takeovers Panel is the primary forum for resolving any disputes in relation to takeover bids. |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|

ASIC INVOLVEMENT

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| <ul style="list-style-type: none"> ◦ ASIC must generally have at least 14 days to review and comment on the scheme documents. ◦ ASIC will also attend the court hearings if it believes there are matters that should be drawn to the court's attention. | <ul style="list-style-type: none"> ◦ Prior review of the bidder's statement and target's statement by ASIC is not required. ◦ ASIC's role is more limited in takeovers than in schemes. |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

KEY PROS AND CONS

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|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> ◦ 100% ownership in a set timeframe. ◦ Likely that a higher stake is needed to be certain of blocking a scheme than a takeover. ◦ Fewer restrictions on conditions. ◦ Cannot be used in hostile deals. ◦ Independent expert's report is effectively mandatory. ◦ Significant court and ASIC involvement. | <ul style="list-style-type: none"> ◦ Can be used in friendly and hostile deals. ◦ More flexibility to vary the terms of the offer. ◦ Pressure to waive 90% minimum acceptance condition, which increases the risk of minorities. ◦ Can be easier for a spoiler to block. |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

5 STRUCTURING THE OFFER

5.1 OFF-MARKET BID OR ON-MARKET BID?

A takeover may proceed by way of an off-market bid or an on-market bid. Off-market takeover bids are by far the most common in Australia. There are some important differences between the two procedures, which are summarised below.

OFF-MARKET BID

ON-MARKET BID

SECURITIES COVERED BY THE BID

- An off-market bid may be made for all or a proportion of the securities in the bid class held by each holder.
- An on-market bid must be for all securities in the bid class held by a holder.

CONSIDERATION OFFERED

- An off-market bidder can offer cash, securities or a combination of both as consideration.
- An on-market bidder can only offer cash.

CONDITIONS

- An off-market bid may be subject to any number of conditions, provided they are not within the control of the bidder or dependent on the bidder's opinion or state of mind.
- An on-market bid must be unconditional (though the bidder may withdraw if the target becomes insolvent or certain other prescribed events occur).

VARIATIONS

- An off-market bid is generally more flexible in terms of variations towards the end of the bid period.
- However, if an off-market bidder increases the bid price, all accepting security holders, including those who have already accepted, are entitled to the increased consideration.
- In an on-market bid, those who have accepted before the increase are not entitled to receive the increased price.

5.2 THE OFFER PRICE

Under both off-market and on-market bids, the consideration offered must equal or exceed the maximum consideration that the bidder or an associate provided for a security in the bid class in the four months before the bid.

The application of this rule can be difficult in the case of a scrip bid that is preceded by a cash purchase of securities in the bid class, or where the preceding purchase is for shares or other assets rather than cash. Complex valuation issues can arise in these circumstances and it may be advisable to seek guidance or a modification from ASIC to clarify the application of the rules.

5.3 CONDITIONS

A bidder should give careful consideration to the conditions it will attach to its bid.

The conditions to a bid give the bidder commercial protection by allowing it to withdraw from a takeover in certain circumstances. Unless the bidder is protected by such conditions, it will not ordinarily be able to withdraw its offers once the bid has been announced and may face civil liability if it purports to do so.

Common conditions in off-market bids include:

- minimum acceptance conditions (50% or 90%)
- conditions relating to material adverse changes in the financial or trading position or condition of the target
- conditions relating to adverse movements in the stock market or in key commodity prices.

However, certain conditions are prohibited. These include:

- maximum acceptance conditions;
- conditions allowing the bidder to acquire securities from some but not all of accepting shareholders;
- conditions requiring approval of payments to officers of the target ceasing to hold office; and

- conditions that turn on the bidder's opinion.

CASE STUDY – DUE DILIGENCE CONDITIONS

In *Goodman Fielder 01*, Burns Philp's bid was conditional on Goodman Fielder's directors confirming the company's restructuring costs, earnings, working capital and liabilities and an actuarial review of a superannuation plan. The Takeovers Panel held that this condition was not unacceptable, but the directors were not obliged to disclose the information. However, the commercial effect of the condition was that key parts of the information were provided.

5.4 VARIATION OF OFFERS

The takeover procedure is quite flexible.

Varying an offer

A bidder has the right to vary its offer provided the variation will benefit target security holders.

An off-market bidder may improve the offer price at any time during the offer period.

An on-market bidder may increase the offer price, but not during the last five trading days of the offer period.

Extending the offer period

Off-market bids

If an off-market bid is unconditional, the bidder may extend the offer period at any time before the end of the offer period.

If the bid is subject to a condition, the bidder may only extend the offer period after the date on which the bidder is required to give notice of the status of conditions (which is

seven to 14 days before the end of the offer period) if another person makes a takeover bid or if the offer price under another takeover bid is improved.

There is an automatic extension of two weeks if, within the last seven days of the offer period:

- the offer price is increased; or
- the bidder's voting power in the target increases to more than 50%.

On-market bids

An on-market bidder may extend the offer period:

- before the last five trading days of the offer period; or
- if, during those last five trading days
 - another person makes a takeover bid; or
 - the offer price under another takeover bid is improved.

5.5 COMPULSORY ACQUISITION

When formulating a takeover offer, a bidder should consider strategies for compulsorily acquiring all outstanding securities in the bid class. Complete (100%) ownership of the target can be important, particularly where a bidder wishes to access the cash flows or assets of the target.

A bidder making a takeover bid will be permitted to compulsorily acquire the remaining securities in the bid class if during, or at the end of, the offer period:

- the bidder and its associates control at least 90% (by number) of the securities in the bid class; and

- the bidder and its associates have acquired at least 75% (by number) of the securities that the bidder offered to acquire under the bid (whether or not the acquisitions happened under the bid).

In addition, a person who is a '90% holder in relation to class of securities' in a company may compulsorily acquire the remaining securities in that class, whether or not the person has made a takeover bid.

A person is a '90% holder in relation to a class of securities':

- if the person holds, either alone or with a related body corporate, full beneficial interests in at least 90% of the securities (by number) in that class; or
- where the securities are either shares or convertible into shares, if the person has voting power in the company of at least 90% and holds, either alone or with a related body corporate, full beneficial interests in at least 90% (by value) of all the securities of the company that are either shares or convertible into shares.

The 90% holder may only use this general compulsory acquisition power within six months after becoming a 90% holder in relation to that class. An independent expert must give an opinion on the fairness of the consideration, and security holders have the right to object in court.

Compulsory acquisition, if unopposed, takes approximately six weeks. It is important to factor this delay into any timetable as the target company cannot be grouped for tax consolidation purposes until the compulsory acquisition procedure has been completed.

6 BID DOCUMENTATION AND PROCEDURE

6.1 BIDDER'S STATEMENT

Introduction

Before either an on-market or off-market bid can be launched, the bidder must prepare a disclosure statement called a 'bidder's statement'. This is a disclosure document meant to inform the target directors and shareholders about the terms of the takeover bid and relevant background information.

Preparation of the bidder's statement can be very time consuming, and drafting should be commenced as soon as practicable.

General disclosure requirements

The bidder's statement must contain the following information:

- details of the bidder's intentions regarding:
 - the continuation of the target's business
 - any major changes to be made to the target's business, including any redeployment of fixed assets
 - the future employment of the target's present employees
- the bidder's financing arrangements in relation to any cash offered under the bid
- details of any purchases by the bidder or an associate for a security in the bid class during the previous four months
- details of any collateral benefits offered to a person by the bidder or an associate, in the previous four months
- any other information known to the bidder that is material to a decision by a holder of securities of the target whether or not to accept the offer and which has not been previously disclosed to them.

Additional disclosure requirements where scrip consideration offered

If securities of the bidder or its controller are to be offered as consideration, in addition to the disclosure requirements listed above, the bidder's statement will also be required to contain information required in a prospectus for the offer of those securities.

6.2 THE TARGET'S RESPONSE: THE TARGET'S STATEMENT

The target must formally respond to a takeover bid by preparing a target's statement. The target's statement must contain, among other things:

- all the information that holders of bid class securities and their professional advisers would reasonably require, and reasonably expect to find, to make an informed assessment of whether to accept the offer (though only to the extent that it is known to any of the target's directors); and
- the recommendations of the target's directors on whether the offer should be accepted, giving reasons for the particular recommendation.

An independent expert's report on the fairness and reasonableness of the offer must also be prepared to accompany the target's statement if the bidder's voting power in the target exceeds 30% or if there is a common director between the bidder and the target. Even if those tests are not met, it is common for an independent expert's report to be included.

The target must send its target's statement (and any accompanying report) to its shareholders, the bidder, the ASX and ASIC

no later than 15 days after the target receives a notice from the bidder to the effect that the bidder has completed dispatch of its bidder's statement to target's shareholders.

6.3 SUPPLEMENTARY STATEMENTS

When will a supplementary statement be required?

The legislation requires a supplementary bidder's or target's statement to be prepared when the bidder or the target, as the case may be, becomes aware that:

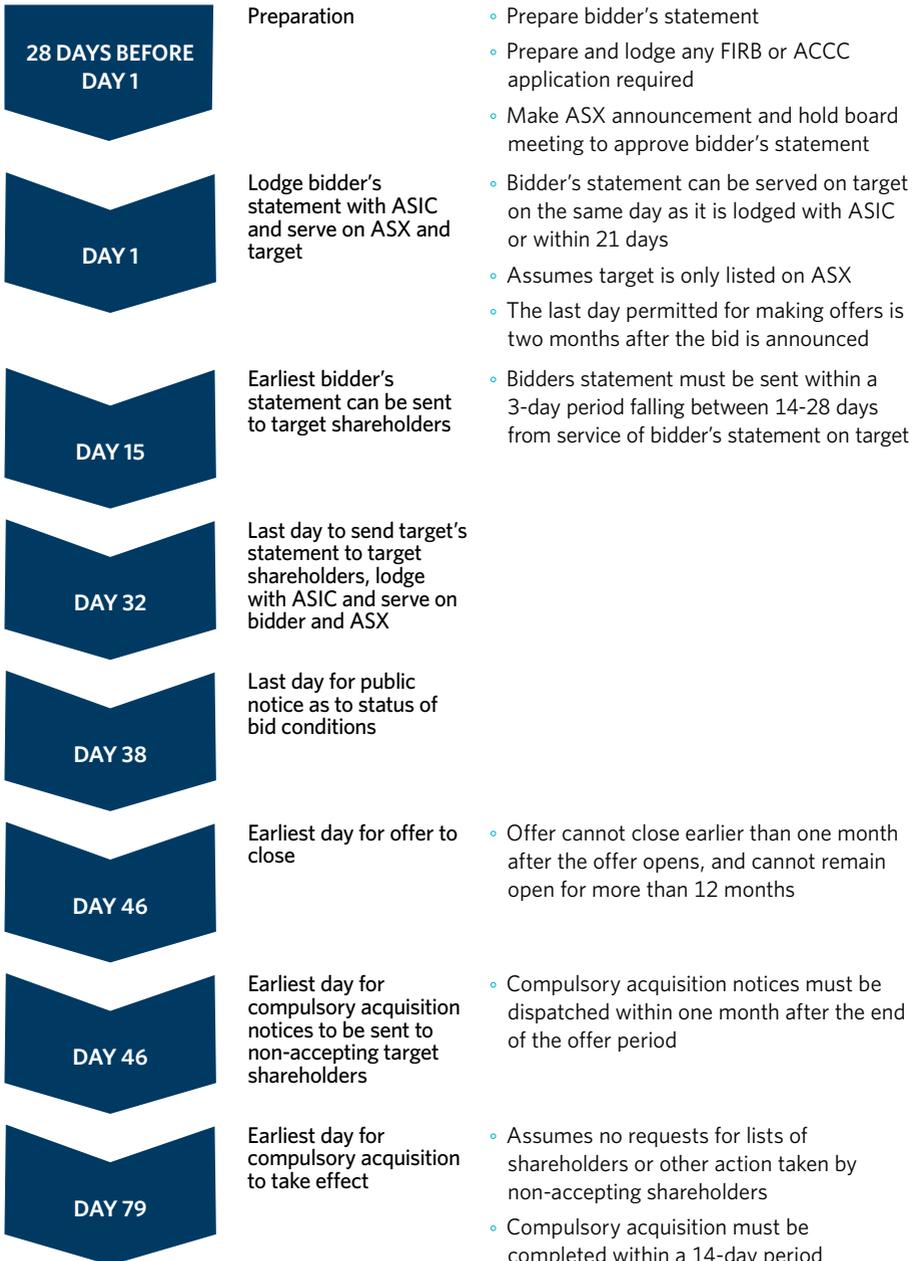
- the original statement contains a misleading or deceptive statement or an omission that is material to a holder of a bid class security; or
- a new circumstance has arisen that would have been required to be included in the original statement had it arisen before that statement was lodged with ASIC.

To whom must the supplementary statement be sent?

The supplementary statement must be sent to the target or bidder (as the case may be) as soon as practicable.

If the target is listed, the supplementary statement need not be sent to offerees. It is only required to be lodged with ASIC, given to the relevant securities exchange and given to the target. If the target is not listed, the supplementary statement will also need to be sent to offerees who have not yet accepted the offer.

6.4 INDICATIVE TIMETABLE FOR OFF-MARKET TAKEOVER BID



7 TAKEOVER DEFENCE

7.1 INTRODUCTION

The prime goal of any corporate activity must be to increase value for the company's shareholders. This extends to action taken to ensure that an inadequate takeover bid for the company will fail.

The directors of a target company have a responsibility to convey to shareholders and to the market all material information so that there can be a fair appraisal of the value of the company and its assets. Defending a company from takeover is essentially about keeping shareholders informed so they may make a sensible decision. It is not about protecting the personal position of management or the directors or keeping the company 'independent'.

Australian law (and the ASX Listing Rules and Takeovers Panel policy, in particular) prohibits a company from adopting strategies designed to prevent a bid being made or to frustrate one that has been made. The types of activities that may be considered are usually divided into activities prior to a bid being made and activities after a bid is announced.

7.2 PRE-BID STRATEGY

Two things are crucial:

- 1 Strong financial performance is the best way to ensure that an inadequate takeover bid will not succeed and that shareholders will remain loyal to the current directors. Institutional shareholders play an important role and today are under more pressure than ever to perform themselves. Companies must strive to ensure adequate returns to

shareholders or find themselves deserted by the institutions.

- 2 The company must have a clear and consistent story to tell about its business. This should be communicated regularly to key shareholders, analysts, the media and the market generally. A detailed communication policy should ensure that shareholders understand and support the company's direction. Close contact with shareholders will also assist in detecting early signs of erosion of their support.

Planning

The company's shareholders will be best served by a coordinated and calm but decisive response to any bid that emerges. Generally, this will require advance planning.

It is common for companies in Australia to have established takeover response procedures and to have established teams of relevant advisers. Typically, this would include key executives, financial advisers and lawyers. The team may be expanded, when appropriate, to include public relations consultants, accountants and specialist valuers. The team should be regularly briefed about the company's activities.

Some specific roles for the team in advance of a bid include:

- monitoring the market understanding of the company and its activities—the company's strengths and weaknesses should be critically reviewed from an operational and financial perspective, and

it should be compared to other companies in which shareholders dissatisfied with the company may invest as an alternative

- instituting a program to ensure that shareholders and the stock market are well informed about the company's activities
- monitoring changes in the underlying ownership of its shares. Directors will be better prepared to protect the interests of the target's shareholders if they are aware of an impending bid. This may be done using the notice procedure permitted under the legislation (see section 8.2 of this guide)
- preparing a takeover response manual outlining immediate strategies in case a takeover bid is announced—this would typically involve forms of announcements to the ASX and letters to shareholders for release containing the company's immediate response to the bid and advice to shareholders
- reviewing potential bidders and counter-bidders—this will assist in a speedy response to any bid emerging.

Defensive strategies

More formal defensive strategies may involve the creation of shareholdings in friendly hands. Examples include allotments in favour of investors likely to support the board and allotments pursuant to employee share schemes. However, a strategic parcel can often add to instability if the holder subsequently becomes a seller of the shares.

Pro-rata issues of new securities will make a bid more expensive or complicated for a potential acquirer.

The target's constitution can also be amended to introduce provisions making a takeover bid more difficult, such as introducing a maximum number of shares that may be held by one shareholder or a sliding voting scale. Such restrictions are not permitted for ASX-listed companies, but they do exist in unlisted companies. Plebiscite provisions that restrict proportional bids may be adopted by listed and unlisted companies.

Share buy-backs may also be useful as a defensive tactic. These may be used to repurchase particular parcels of shares or to enhance earnings per share.

The most effective defence, of course, remains good financial performance, which puts a premium on the share price and keeps shareholders satisfied and loyal to management.

7.3 RESPONDING TO A TAKEOVER BID

Immediate response

Once a bid is announced, the key task for the defence team is to assess the offer and assist the company directors to provide advice or alternatives for shareholders.

If a bid is announced, the first step is to gather together the defence team to map out a response. This will usually require a board meeting to be convened urgently. If this cannot be done promptly, it is usual for the directors to release a 'holding statement' urging shareholders not to take any action until a more detailed response can be prepared.

The range of possible activities for the target directors after a bid is announced is restricted by the ASX Listing Rules, which

restrict the ability of the company to make placements, and by the Takeovers Panel policy against the target company undertaking any action that may frustrate the bid (see section 9.1 of this guide). In addition, once a bid is announced the directors may be forced to be more circumspect in their actions due to an increased likelihood of allegations that their actions have been motivated by improper purpose, namely to frustrate the bid for their own purposes.

CASE STUDY — FRUSTRATING ACTIONS

In *Gondwana Resources O2*, Gondwana was subject to a conditional off-market bid by Ochre Industries. Prior to the disclosure of the bid, Gondwana announced a 1 for 1 non-renounceable, partially underwritten rights issue. Ochre claimed that the proposed rights issue, which was not subject to shareholder approval, would trigger the defeating condition of the bid and was therefore a frustrating action. The Takeovers Panel agreed with Ochre's argument that the rights issue constituted a frustrating action and considered that in not seeking shareholder approval, Gondwana failed to give its shareholders a reasonable and equal opportunity to participate in the benefits of the bid.

Directors should concentrate on an analysis of the bid and the company and communicate this to the shareholders and investment community generally. It may be desirable to seek to restrain the bid from proceeding if the offer contravenes rules relating to pricing or conditions, does not meet legal disclosure requirements or

misleads shareholders. Specific actions against an unsolicited takeover bid may include:

- criticising the offer as inadequate;
- disclosing favourable information about the company;
- criticising the bidder and its performance;
- taking legal action to ensure the bidder has complied with all applicable legal and disclosure requirements; or
- seeking a rival bidder.

Formal response

The target company's formal response to a takeover bid is the target's statement. (This document is discussed in further detail in section 6.2.)

Effect on the target company's business

The making of a takeover bid should not affect how the company carries on its business. However, any action that may trigger a breach of a bid condition may be regarded as 'unacceptable' by the Takeovers Panel, requiring it to be subjected to a shareholder meeting.

8 DISCLOSURE OF SHAREHOLDINGS

8.1 SUBSTANTIAL HOLDING NOTICES

A person that has, either alone or together with associates, control over 5% or more of voting shares in a listed company has a 'substantial holding' in that company and must fulfil certain notification requirements.

A person must, within two business days, give a notice that sets out certain details of their holding to the company and to each relevant securities exchange once they:

- begin to have, or cease to have, a substantial holding; or
- increase or decrease a substantial holding by 1% or more.

8.2 NOTIFICATION DURING A TAKEOVER

A person making a takeover bid for a listed company must notify the company and each relevant securities exchange of certain information, including details of the interests that they and their associates have in the company by 9.30am on the next trading day after the commencement of the bid.

The bidder is deemed to have a substantial holding in the target during the takeover period and, therefore, whenever there is a movement of at least 1% in the bidder's holding, the bidder must notify the company and each relevant securities exchange of this fact by 9.30am on the next trading day.

8.3 TRACING CONTROL OF SHARES

The Corporations Act provides a procedure whereby a listed company or ASIC can trace ultimate control of a parcel of shares in the

company regardless of the size of the parcel. Any shareholder of the company may also require ASIC to initiate the procedure unless ASIC considers that it would be unreasonable to do so.

The procedure is initiated by the giving of a notice to the shareholder. That notice directs the shareholder to disclose certain information, including:

- full details of the holder's control over the shares;
- the identity of other persons who also have some control over the shares; or
- the identity of persons who have given the holder instructions about the acquisition, voting and disposal of the shares.

The shareholder must provide the information to the company within two business days after being given the notice.

A bidder can use these notices as a way of uncovering the beneficial ownership of shares in the target, when attempting to solicit acceptances. Likewise, a company that believes it may be a target for a bid, can use these notices to monitor changes in its register. Potential targets periodically serve tracing notices on their largest nominee shareholders in order to monitor movements in the underlying ownership of their shares.

9 DISPUTE RESOLUTION

9.1 THE TAKEOVERS PANEL

Introduction

The Takeovers Panel takes the place of the courts as the principal forum for resolving takeover disputes until after the bid period. The only exceptions to this are in the case of criminal prosecutions and certain other proceedings commenced or referred by ASIC or the Panel itself or by other public authorities.

The Panel's role and power

The Panel has the power to:

- declare circumstances in relation to the affairs of a company to be 'unacceptable circumstances' and make a wide range of orders; and
- review on its merits a decision of ASIC to exempt or modify the takeover rules.

Who may apply to the Panel?

An application to the Panel may be made by the bidder, the target, ASIC or any other person whose interests are affected by the relevant circumstances. Similarly, any interested person whose interests are affected will be able to apply for review of an ASIC takeover decision.

'Unacceptable circumstances'

The Panel's jurisdiction to make a declaration of 'unacceptable circumstances' does not depend upon the existence of a general offer to shareholders under a takeover bid. The Panel will have jurisdiction in all circumstances involving an acquisition of a substantial interest in, or control of, a

company. The Panel may declare circumstances to be unacceptable whether or not the circumstances constitute a contravention of the Corporations Act.

In deciding whether the circumstances are unacceptable, the Panel must have regard to the policy principles (often referred to as the 'Eggleston Principles') underlying the takeover rules, the provisions of Chapter 6 of the Corporations Act and any other matters it considers relevant. The Panel may only make, or decline to make, a declaration where it is not against the public interest to do so.

The Panel will have the power to make a wide range of orders that it thinks appropriate, either on an interim basis following an application for a declaration of 'unacceptable circumstances' or as a final order once the declaration is made. In particular, the Panel will be able to make orders to:

- ensure that a takeover bid proceeds in a way that it would have proceeded if the circumstances had not occurred;
- prevent a person from acquiring securities; and
- direct a person to dispose of securities and award costs.

Internal Panel reviews

A party to Panel proceedings or ASIC may apply to the Panel for review of a decision of the Panel. After conducting a review of a decision, the Panel may vary or set aside the decision.

9.2 THE COURT'S ROLE

Court proceedings before end of bid period

Once a takeover bid has been announced, only ASIC or another public authority of the Commonwealth or a state will be able to apply to the court to stop or affect a takeover bid. This is intended to reduce takeover disputes.

However, the Panel may refer a question of law arising in a proceeding before it to the court for decision.

Court proceedings after end of bid period

A court's powers may be enlivened after the end of the bid period if an unsuccessful application to the Panel for a declaration of unacceptable circumstances has been made and the court finds that the conduct in question contravenes the Corporations Act. In that case, the court may:

- determine whether a person has been guilty of an offence and impose a penalty if the person is found guilty; and
- determine that a person has contravened a provision of the Corporations Act and order that person to pay an amount of money to another person (whether by way of damages, account of profits, pecuniary penalty or otherwise).

10 ALTERNATIVES TO FORMAL TAKEOVER BIDS

10.1 INTRODUCTION

As mentioned earlier, there are various other ways in which a person can increase its voting power beyond 20% without launching a formal takeover bid. The primary practical alternatives to a takeover are outlined below.

10.2 APPROVAL BY RESOLUTION OF TARGET

An acquisition can be specifically approved by an ordinary resolution of independent shareholders of the target. However, before voting on the resolution, the independent shareholders must have been given all information known to the person proposing to make the acquisition or their associates, or known to the company, that was material to the decision on how to vote. In practice, an independent expert's report is generally required.

10.3 THREE PER CENT CREEP IN SIX MONTHS

A person may acquire up to 3% of a company's shares every six months, provided that, as a result of the acquisition, neither that person nor any other person would have voting power in the company more than 3% higher than they had six months before the acquisition.

10.4 EXEMPTED DOWNSTREAM ACQUISITIONS

If a person acquires more than 20% of the voting power in a company (whether registered in Australia or elsewhere), that person will be deemed to have also acquired control over any securities that that company controls. If that company controls securities conferring more than 20% of the

voting power in an Australian listed company or an unlisted Australian company with more than 50 shareholders (the downstream company), the person will infringe the general 20% prohibition.

So that this is not used to frustrate other takeover bids, the legislation contains a broad exception that will apply whenever the downstream acquisition results from another acquisition of voting securities in a company included in the official list of:

- the ASX; or
- a foreign body conducting a stock market that is a body approved by ASIC in writing.
- ASIC has approved various foreign stock markets which require bodies on their official list to comply with takeover rules or regulations that offer a level of investor protection comparable to that offered in Australia. ASIC's view is that reliance on this exemption in circumstances where control of the downstream company is a 'significant purpose' of the upstream acquisition may give rise to unacceptable circumstances.

10.5 CAPITAL RAISINGS

Increases in voting power over 20% may occur lawfully as a result of participation in rights issues, including in the capacity of underwriter. However, if the issue is structured so as to deliver an increased holding to the underwriter, the Takeovers Panel may declare the acquisition to be unacceptable.

10.6 SCHEMES OF ARRANGEMENT

As mentioned before, a scheme of arrangement can be used to effect the acquisition of a target company by an acquirer.

A scheme of arrangement will be binding upon all shareholders if approved by:

- a majority in number of the shareholders, present and voting either in person or by proxy;
- being a majority holding at least 75% of the total number of shares of the shareholders present and voting in person or by proxy.

A scheme of arrangement is therefore an 'all or nothing' proposition, that is, the scheme will either be approved in its entirety or rejected by shareholders.

Any shares held by the acquirer cannot be voted in support of the scheme. Only independent shareholders may vote.

A scheme of arrangement involves two applications to the court, one to convene the scheme meeting and the other to approve the terms of the scheme. There is always a residual risk that the court may either refuse to convene the meeting or refuse to approve the scheme of arrangement. The court will carefully consider any objections and will refuse to approve the scheme if it considers that

shareholders or creditors may be unfairly prejudiced by it.

In addition, the court must be satisfied that the scheme of arrangement is not proposed in an attempt to avoid the takeover provisions. As the scheme of arrangement process is substantially within the control of the target, it is therefore not appropriate in a hostile acquisition.

For further information on the process relating to schemes of arrangement, contact Herbert Smith Freehills for a copy of our guide to *Schemes of Arrangement in Australia*.

11 CONTACTING US

If you have any questions relating to this booklet or any other aspect of takeovers or corporations law, please contact one of the partners in the Corporate group at Herbert Smith Freehills in Australia. Details are on our website **herbertsmithfreehills.com**

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