Takeovers Panel

Lock-up Devices Guidance Note

Introduction

1. This Guidance Note[1] considers the lock-up devices known as break fees, asset lock-ups, no-talk agreements and no-shop agreements.

2. In this Note, the Panel indicates what lock-up devices it will find unacceptable in relation to a bid or other control transaction.[2]

3. Subject to certain principles concerning the objective and effect of the agreement and the amount of any break fee, the Panel does not regard lock-up devices to be *prima facie* unacceptable.

4. The Panel will normally consider that a lock-up device gives rise to unacceptable circumstances if it prevents the acquisition of control of a target taking place in an efficient, competitive and informed market.

5. Whether circumstances are unacceptable depends on the effect of the lock-up device on shareholders and on the market, in light of the policy of sections 602 and 657A of the Corporations Act. It does not depend on the occurrence of unacceptable conduct or any intention to bring about an objectionable state of affairs.

6. The Panel considers that lock-up devices is an area which has and will continue to evolve in Australia. The Panel will monitor the evolution of, and its own experiences with, lock-up devices, and will be prepared to adjust and adapt this Note to keep it current and relevant.

7. The Panel will examine on a case-by-case basis whether a lock-up device gives rise to unacceptable circumstances.

Criteria

8. In assessing the effect of a break fee or other lock-up device on competition for control of the target, the Panel will consider:

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[1] The Panel's Guidance document will guide the Panel's administrative decision-making when implementing the legislation and legislative policy.

[2] In this Note, all references to a bid include, where appropriate, any proposal involving a change of control. This Note will also cover schemes of arrangement, which are within the Panel's jurisdiction (subject to the Court's supervisory role).

- the value of the fee or the significance of the agreement and its likely effect on any current, or any possible future, rival bid;
- whether the agreement is entered into for the purpose, or likely to have the effect, of encouraging a person to make or persist with a bid;
- whether the target board considers that it is in the best interests of shareholders to promote a particular bid;
- whether the target board is explicitly allowed to fulfil its obligations to its shareholders;
- whether the target board is restricted from dealing with a rival bidder, particularly if the rival bid is on better terms; and
- any other matters it considers relevant.

9. A lock-up device may also lead to unacceptable circumstances if it results in shareholders not having a reasonable and equal opportunity to participate in benefits accruing to shareholders in connection with a control transaction. Shareholders may be denied reasonable access to benefits accruing under a bid if directors enter into an agreement that effectively limits shareholders' power to decide the ownership of the company.

Break Fees

10. A break fee is an arrangement entered into between a bidder or potential bidder and the target by which consideration will be payable by the target if certain specified events occur which have the effect of preventing the offer from proceeding or causing it to fail.

11. A break fee can also be paid by a bidder (e.g. where a bidder may be willing to pay a break fee in return for a period of exclusive negotiations or a due diligence opportunity).

12. A break fee may also be agreed in relation to other transactions, such as an agreement between vendor and purchaser, or an agreement by a target if shareholder approval for an acquisition or a share placement is not given.

13. The Panel will generally not regard a break fee as unacceptable if it is, in all the circumstances, reasonable and consistent with the Eggleston principles.

The 1% guideline

14. In all cases where a break fee is proposed, the Panel considers that it is good practice for target directors to negotiate a capped figure (dollar or

percentage based) as the maximum fee payable when entering into break fee agreements. In this regard a cap of 1% of the bid value is a reasonable guideline.[3]

15. However, the amount of the cap should be appropriate to the circumstances (e.g. in low value bids the costs may reasonably exceed 1% and in large bids a fee of 1% may be excessive). In exceptional circumstances, a Panel may have regard to the gearing of the target and take into account the overall enterprise value (equity value plus debt) in considering what is the appropriate basis for the 1% guideline.

16. Where there are multiple fee arrangements (in respect of multiple asset transactions or otherwise) the Panel will generally aggregate them for the purposes of the 1% guideline.

Relevant factors

17. A break fee may consist of any fee or pecuniary benefit that reimburses reasonable bid costs (or a reasonable estimate) related to internal costs, third party outgoings, and, in appropriate circumstances, reasonable opportunity costs (for further guidance see the Annexure to this Note).

18. A break fee must be negotiated on an arms length basis and must not have the effect of impeding competition in the market for control of the target.

19. In assessing the effect of a break fee on competition for control of the target, the Panel will have regard to factors including:

    - what bids were expected or likely at the time;
    - whether the bids known or expected were reasonably regarded by the target board as inadequate;
    - whether the bid which a break fee induces will offer shareholders special value for their holdings;
    - whether the target sought out other prospective bidders;
    - who made the initial approach; and
    - the effect of the fee on the conduct of the counterparty and any other bidders.

[3] The value used in calculating the cap is the total value of the class of bid securities, based on the value of the consideration being offered at the date of the announcement of the bid.

20. A break fee is likely to be unacceptable where its size puts pressure on shareholders to accept a bid.

21. This may be a particular concern if a break fee is payable where the proposal is rejected by shareholders in the absence of any competitive rival proposal and in the absence of any material change in circumstances. The Panel is not totally opposed to a break fee being payable in these circumstances (since the fee may operate as an "option fee" to secure a corporate opportunity), but the level of the fee should not be so high as to influence materially shareholders' decisions.

22. A break fee may also be unacceptable if it is inconsistent with the principle that all holders of bid class securities have a "reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest" in the target. This may be the case if the break fee can properly be characterised as a collateral benefit in relation to another person's bid or proposed bid.

Break fees agreed with a major shareholder

23. A break fee agreed with a major shareholder of a target as part of an arrangement for that shareholder to sell all or part of its holding to the bidder (either directly or by accepting the bid) gives rise to some additional considerations. The Panel will remain concerned to assess the effect of a break fee on competition for control of the target and will therefore consider all of the principles outlined above.[4]

24. However, the Panel will also be concerned to ensure that the arrangement does not defeat the purpose of section 606 by allowing the bidder effectively to control the disposal of shares above the 20% threshold otherwise than under one of the exceptions listed in section 611 (if the shareholder must pay a fee if it does not accept the bid, it may have an economic incentive to accept that bid even if a higher rival bid emerges).

25. An arrangement that may be acceptable if it is entered into after an effective auction process has been conducted may well be unacceptable if no such process has been conducted.

[4] The 1% cap will be calculated on the value of the shares held by the shareholder rather than the target's market capitalisation. However, a higher percentage fee in this context may not be unacceptable if it does not adversely affect competition for control of the target.

No-Shop and No-Talk Agreements

26. A no-shop agreement is an arrangement entered into between a bidder, or potential bidder, and the target by which a target agrees not to solicit an offer from a third party, usually during some defined period of exclusivity.

27. A no-talk agreement is an arrangement entered into between a bidder, or potential bidder, and the target by which a target agrees not to negotiate with any bidder or potential bidder, even if that bidder's approach to the target is unsolicited.

Safeguards

28. Target directors need to be convinced of the proper commercial and competitive benefits to their shareholders before agreeing to this form of agreement. The period of restraint must be limited and reasonable, but may extend into the bid period where this is justifiable having regard to the advantages that the agreement offers to target shareholders.

29. In every case, what is acceptable if the bidder is likely to be the only suitor or if the target has already conducted an effective auction process, may not be acceptable if there are likely rival proposals or if the target has not conducted an effective auction process before agreeing to the arrangement.

30. Procedural requirements may also increase the anti-competitive effects of the agreement if they might oblige the target to provide details of any discussions regarding alternative proposal to the original bidder or restrict the target in communicating relevant information to a potential rival bidder.

Fiduciary carve-out in no-talk agreements

31. The Panel regards it as essential that a no-talk agreement be subject to an appropriate 'fiduciary carve-out', allowing directors to consider any better proposal if they form the view that to do so would be in the best interests of target shareholders. The Panel does not require that a no-shop agreement be so constrained, because it considers that a no-shop agreement is materially different in that directors do not have a clear duty to seek out or solicit other offers, although they must remain open to the consideration of such offers.

32. All features of a no-talk or no-shop agreement need to be considered in determining the likely effect on competition. For example, a 'fiduciary carve-out' might only allow directors of the target to consider an alternative proposal if they receive advice from a third party that it is a

superior proposal or if they receive legal advice that they are obliged to consider the alternative proposal. While it may be appropriate for the bidder to request features to be included in the carve-out requirements to ensure the no-talk agreement achieves its commercial objectives, these features should not be excessively restrictive or materially inhibit the target from considering alternative proposals which may be in the best interest of target shareholders.

Asset lock-ups

33. An asset lock-up is an arrangement which may be entered into between a bidder, or potential bidder, and the target.[5] For example, an agreement by the target to sell a particular asset or specified assets in exchange for an agreement by the bidder to make a bid.

34. Alternatively, an asset lock-up might involve an arrangement whereby the bidder agrees to buy a particular asset or specified assets in exchange for a defined period of exclusivity or the opportunity to undertake due diligence.

35. There has been little experience of asset lock-ups in Australia. However, in other jurisdictions, they have often met with disfavour. If an asset lock-up involves an agreement to sell an important asset of the target (often the target's so-called "crown jewels"), it can have the effect of making the target a less attractive acquisition candidate. Accordingly, an asset lock-up may have the effect of eliminating meaningful competitive bidding for the target. In Australia, any asset lock-up having this effect is likely to be unacceptable on the basis that it would not be consistent with an efficient, competitive and informed market.

36. If an asset lock-up were entered into with a potential rival bidder (or as part of some other transaction) after the target company had received notice of a takeover bid or proposed takeover bid, the asset lock-up may also constitute "frustrating action" requiring scrutiny under the principles set out in the Panel's decision in the Pinnacle 8 matter. This may also give rise to unacceptable circumstances.

37. Even if a proposed asset lock-up would not directly eliminate meaningful competitive bidding for the target, the lock-up may nevertheless still be unacceptable if certain safeguards are not observed. In particular, the agreement should be negotiated on an arms length basis, should be at a fair price and should not adversely affect the amount or distribution of benefits accruing to shareholders in the target in connection with the takeover.

[5] The Panel recognises that companies may enter bona fides asset lock-up agreements well prior to, and outside the context of, a takeover bid. This Note applies only to asset lock-ups entered into in the context of an existing or proposed takeover bid.

38. In the absence of an appropriate commercial reason for giving such an asset lock-up, the agreement may give rise to unacceptable circumstances. In general, asset lock-up devices are likely to be exposed to more scrutiny, and run more risk of being unacceptable, as the size or strategic value of the asset increases.

39. The Panel considers that it is good practice for a target board to seek advice from a clearly independent expert on the appropriateness of any fixed price, or price formula, asset lock-up agreement.

Disclosure

40. The Panel requires immediate disclosure of the existence and nature of any lock-up device in an announcement to the respective home exchanges of the bidder and target (if they are listed). The bidder's statement and target's statement (or any other relevant document, such as an explanatory statement for a scheme of arrangement) should fully disclose the terms of the lock-up device.

41. The directors of the target should explain in the target's statement (or other explanatory document) why they have entered into the agreement, having regard to its effect on competition.

Process

42. The Panel expects that if a break fee or other lock-up device comes before the Panel, directors will be able to evidence their decision making process in considering the relevant issues relating to lock-up devices (including any advice taken) and the evidence of the appropriateness of entering the arrangements.

Remedies

43. The Panel has a wide power to make orders (including remedial orders) if it finds that a lock-up device gives rise to unacceptable circumstances. For example, the Panel may cancel or declare voidable an agreement relating to a takeover bid, or a proposed takeover bid, or any other agreement in connection with the acquisition of securities.

Legality

44. This Note is not a statement of the law. Whilst the Panel would not wish to facilitate a lock-up device which appeared to be clearly invalid, the fact that a Panel did not declare an agreement to be unacceptable would not affect its legality or enforceability.

45. Directors may still breach their duties by entering into a lock-up device that complies with this Guidance Note. For example, a lock-up device

acceptable under this Note may be void or unenforceable because it contravenes the law relating to directors' duties, reductions of capital, or related party transactions. Therefore, prior to entering into a particular lock-up device, directors must consider their fiduciary duties and statutory obligations and are advised to seek expert legal advice.

Annexure

Recovery of Reasonable Outgoings, Expenses and Opportunity Costs

1. Whether a break fee is reasonable depends on both the nature and the amount of the outgoings and costs to which it is directed. The test is how much the target board would prudently pay, having regard to its fiduciary obligations and to the situation of the company, to induce the bidder to make or persist with its bid.

2. Reimbursement of fees for legal and financial advice on the relevant transaction is acceptable, if the fees and their amounts are reasonable and it would have been reasonable for the bidder to incur them, even in the absence of the fee arrangement. It will help to demonstrate that the fees are reasonable if there are arrangements to limit them to what is reasonable in the circumstances, such as a dollar or percentage cap, and arbitration in the event of dispute.

3. Reimbursement of internal costs is acceptable on a similar basis, especially if they could reasonably have been paid to external advisors (e.g. for legal or financial advice).

4. Reimbursement of opportunity costs is a difficult area. Where they are accepted, they will only be acceptable in relation to the reasonable opportunity costs to the bidder of making its bid, and will not be acceptable where they are to reimburse profit expected on the success of the proposed bid. The Panel recognises the difficulty in quantifying opportunity costs and does not necessarily expect parties to such agreements to do so. Rather, any allowance for opportunity costs should be included within the dollar or percentage amount to which the agreement is capped. Parties to a break fee should be able to justify the inclusion of opportunity costs where they form part of the agreement.

5. When considering what quantum is reasonable for a break fee, target directors should also consider what costs and expenses (if any) the target company is likely to have expended in advancing the proposal. Where the target company shares material costs (such as in making submissions to regulators, drafting shared documents, or hiring experts or advisors) these might be set against any opportunity cost which the bidder might assert.

6. The Panel does not see any basis for reimbursement of success fees.

7. Fees that are penal in nature or amount or which constitute windfall gains to the counterparty, are less likely to be acceptable.