Takeovers Panel

Issues Paper
Insider Participation in Control Transactions

Wednesday, 21 February 2007

Overview

1. The Takeovers Panel (the **Panel**) is considering whether to issue a Guidance Note to provide takeover market participants with guidance on circumstances that may arise where there is insider participation in control transactions and when the Panel may declare such circumstances to be unacceptable having regard to the purposes of Chapter 6 of the *Corporations Act* 2001 (**Act**), set out in section 602 of the Act.

2. The Panel invites comment on the policy issues set out in this Issues Paper regarding insider participation in control transactions. This Issues Paper is intended to be read together with the draft Guidance Note on Insider Participation in Control Transactions, which discusses the policy issues under consideration. Unless stated otherwise, terms used in the Issues Paper have the same meaning as those defined in the draft Guidance Note.

3. This Issues Paper sets out the policy issues on which the Panel is considering providing guidance in the draft Guidance Note and the policy issues on which the Panel does not currently intend to provide guidance. The Panel invites comment on the policy issues which are currently addressed in the draft Guidance Note as well as any policy issues not currently addressed in the draft Guidance Note.

Panel's Jurisdiction

4. As noted in the draft Guidance Note, the circumstances which are discussed in the draft Guidance Note also raise issues relating to directors' and employees' duties, employment law and the duties and terms of engagement of advisers. The Panel does not regard it as being its primary role to determine and enforce such duties and obligations. However, the Panel does consider that the existence of such overlap would not limit its responsibility to consider the issues where they affect the principles set out in section 602 of the Act. Do you agree with this approach?

Private Equity and other buy-outs

5. When the Panel commenced its consideration of these issues in November 2006 it was primarily motivated to do so against the background of some private equity takeover bids[1] both in Australia and overseas. However, following its initial work, the Panel considers that framing the draft Guidance Note in terms of private equity issues would be too narrow. The Panel considers that the issues of insider participation apply more widely than simply to private equity

[1] The Panel notes that the concept of "private equity", and any description of its participants, is rapidly changing and developing, which would make guidance based on private equity very prone to being outdated quickly.

bids, and indeed to other buy-outs, and therefore has formulated this draft Guidance Note in terms of participation by insiders, regardless of the nature of the bidder.

6. As set out in the draft Guidance Note, the Panel considers that private equity takeover bids and other buy-outs should be regulated in a similar manner to bids by other types of bidders unless there are proper reasons for not doing so.

7. The Panel recognises that private equity bids and other buy-outs can have a significant effect on markets and that the decisions as to the ownership of companies lie with properly informed target company shareholders.

8. Questions relating specifically to private equity bids and other buy-outs:

   Do you agree with:

   (a) not limiting the draft Guidance Note to takeover bids by private equity and other buy-outs;

   (b) the Panel's selection of issues to include in the draft Guidance Note; and

   (c) the manner in which private equity and other buy-out issues are addressed in the draft Guidance Note.

Participating Insiders

9. The terms "insider" and "participating insider" are discussed in detail in paragraphs 9 to 11 of the draft Guidance Note.

10. The Panel intends by its definition or description of insiders and participating insiders, to include those persons who are likely to have conflicts of interest which may affect the efficient competitive and informed market for the target's shares and for control of the target. The definition is not intended to be exhaustive and will be interpreted to give effect to the principles behind it rather than strict application of the examples given.

11. The Panel does not intend to impede normal business transactions or relationships which are not relevant in the context of a control transaction. However, the Panel will be concerned if professional and other advisers who, by reason of their previous association with a target company have come into possession of "non-public" information seek to become part of an actual or potential bidding vehicle or bidding consortium, either in a professional capacity or as equity participants in such bidding vehicle or consortium, where the issues raised in the draft Guidance Note are not clearly adequately addressed.

12. The Panel does not intend that an adviser would be a participating insider under the proposed Guidance Note if its engagement agreement with the target provided for "performance" or "success" fees to be paid by the target. The Panel considers that such performance fees negotiated with the target company (or IBC) do not raise the conflict issues that arise where advisers, who have previously advised the target company, then seek to advise a bidder or potential bidder, or participate in a bid or proposed bid for the target company.

13. Questions on "participating insiders":

    (a) Do you agree with the scope of the definition of "insider"? Is it too wide or too narrow?

    (b) Do you agree with the scope of the definition of "participating insider"? Is it too wide or too narrow?

    (c) Should the Panel provide a more "fuzzy" definition to deter avoidance of the proposed, more detailed approach?

    (d) Are there specific classes of persons, or types of transactions which the Panel should address?

Addressing Potential Conflicts of Interests

14. Paragraphs 12 to 20 of the draft Guidance Note address potential conflicts of interests for insiders who participate in a control transaction. Insiders who participate in a bid or proposed bid by having arrangements or understandings with the bidder and who have a financial incentive to ensure that the bid is successful are participating insiders. Participating insiders may also have an interest in preventing potential rival bidders from making a bid for the target company and/or limiting the quality and amount of information provided to the potential rival bidders. This would be in order to deter other rival bidders and the market from being able to properly assess the value of the target company and achieve a lower price for the bid in which the participating insider is involved. This may create a conflict of interests which may have an effect on the efficient, competitive and informed market for the target's securities.

15. Questions on addressing potential conflicts of interests:

    (a) Do you agree that insider participation has the potential to create the types of conflicts and effects on the principles set out in section 602, that are described? Do you consider that they warrant Panel guidance?

    (b) Do you agree with the Panel's view that as soon as the target board becomes aware of a potential takeover bid in which there is the potential for some insider participation, or the board is advised by an insider of an approach concerning such a possible proposal, it should establish appropriate processes and protocols to manage the issues which arise? Do you consider that the Panel should or should not prescribe what these might entail?

    (c) Paragraph 18 of the draft Guidance Note sets out examples of protocols that the target board (or the IBC) may consider adopting to address potential conflicts.

        (i) Do you agree with the protocols listed as examples?

        (ii) Should the Panel's guidance be more or less prescriptive about the specific content of protocols which a board or an IBC should adopt?

        (iii) Are there other protocols which should be included?

(d) Do you agree with the Panel's approach that where a target board chooses not to adopt some or all of the protocols listed as examples by the Panel, the protocols that are adopted by the board should be no less effective in ensuring an efficient, competitive and informed market for the target's securities?

Competition for Target Companies Where Insider Participation

16. The Panel considers that where insiders participate in or are involved in a proposed takeover bid with the bidder, processes need to be clearly in place to ensure the maintenance of an efficient, competitive and informed market for the company's securities, and to ensure that a potential rival bid is not precluded or materially inhibited by insiders' involvement in the first bid. This would largely be the role of the independent directors of the target company, who would be required to be more actively involved than would otherwise normally be the case in bids that did not involve insider participation.

17. The Panel is concerned that there may be a perception that bids that involve insider participation may be materially more likely to succeed than other rival bids, and is interested in canvassing opinions as to whether there is a need for the Panel to provide some clear statements and direction to ensure that potential rival bidders are not deterred from pursuing a takeover opportunity from the outset.

18. Questions on competition:

(a) Do you consider that bids with insider participation may materially and adversely lessen competition for the target company?

(b) If so, what steps other than those outlined in the draft Guidance Note may be appropriate?

(c) Should directors of a target company that is subject to a takeover bid which includes insiders be expressly required to conduct an actively managed auction, or other form of competitive process, for control of the company, or is it acceptable for them merely to deal with those approaches that others make to them?

Provision of Information to Potential Rival Bidders

19. There is currently no general requirement that a target company must provide equal information to rival bidders.[2] This principle was recognised in *Goodman Fielder 02* [2003] ATP 5, where the bidder, Burns Philp & Company Ltd, sought orders from the Panel for access to management information provided to Goodman Fielder Ltd to possible rival bidders. The Panel declined to grant the requested orders. The Panel in that case considered that it had found no grounds to "override Goodman Fielder's right to choose to whom and on what terms to provide access to its proprietary information in the best interest of

[2] Goodman Fielder 02 [2003] ATP 5

Goodman Fielder and its shareholders."[3]

20. The Panel has considered the Goodman Fielder principle in the context of insider participation. The Panel considered whether a potential rival bidder should have access to the same information, and in the same time frame, as a bid which includes participating insiders. The Panel also considered the proposition that has been put to it that a rival bidder should have a greater right to access to information where a bid which involves participating insiders is recommended by the board of the target company.

21. In the draft Guidance Note the Panel adopts the view that where target directors do not provide equal information to potential rival bidders, they should have sound reasons for their decision i.e. the Goodman Fielder 02 position. However, due to the competitive advantage such information gives a bidder with insider participants, the Panel is likely to scrutinise very carefully, if it receives an application, the circumstances and reasons given by target directors, in order to ensure the reasons and outcome are consistent with the purposes of Chapter 6 of the Act, especially where the bid involving participating insiders is recommended.

22. The Panel considers that target directors must act in accordance with their duties in deciding whether to provide information to potential rival bidders or allow them to undertake due diligence, including considering any appropriate confidentiality requirements or protocols. In determining how they should act, target directors would normally be expected to consider the terms and conditions of the alternative proposal, its level of certainty, whether it is superior to the existing proposal and whether the rival bidder is a competitor to the business of the target company.

UK Comparison

23. The Panel notes that its proposed approach differs somewhat from the approach taken in the UK. Although direct comparison of individual provisions of the Australian and UK regulations is difficult because of the significant differences in the regulatory regimes and the markets, the Panel has considered how these issues may be approached in London under its regulatory regime.

24. Rule 20.2 of the City Code on Takeovers and Mergers[4] (**UK Code**) seeks to ensure that bona fide potential rival bidders, if they request, have access to the same information as other bidders, regardless of the source of funding for the bid and even if the other potential bidder is hostile. Note 3 to Rule 20.2 states that if the offer or potential offer is a management buy-out or similar transaction, the information to be given to competing bidders is that information generated by the target company (including by the management of the target acting in their capacity as such) which is passed to external financiers or potential financiers of the management buy-out bid.

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[3] In the Panel's Media Release of 6 February 2003 announcing the Goodman Fielder 02 decision.
[4] http://www.thetakeoverpanel.org.uk/new/codesars/DATA/code.pdf

25. Rule 20.3 requires that the bidder in a management buy-out or similar transaction must, on request, promptly provide the independent directors with all information which the bidder has provided to its financiers or potential financiers of the bid.

26. Questions on provision of information to potential rival bidders:

    (a) Should the principle espoused in Goodman Fielder 02 continue to apply where there is insider participation in a takeover bid? Or should the situation in Goodman Fielder 02 be distinguished in such cases?

    (b) Should a decision by the independent directors to recommend a bid affect whether or not those independent directors provide information to a bona fide rival bidder? Is the answer different if there are no participating insiders involved in the recommended bid?

    (c) Is it appropriate generally for the Panel (if it receives an application) to scrutinise more closely decisions by directors not to provide equal access to rival bidders in bids involving participating insiders, and especially where the bid involving participating insiders is recommended?

Disclosure to Shareholders

27. Paragraphs 23 to 26 of the draft Guidance Note set out the Panel's views about disclosure to shareholders by bidders and targets, where there is insider participation in those takeover bids.

28. Under section 638, a target's statement must include all information that shareholders would reasonably require to make an informed assessment whether to accept the offer under the bid, if it is reasonable for investors and their professional advisers to expect to find the information in the target's statement and if the information is known to **any** of the directors of the target. This would include material information known to any directors of the target company who are participating insiders. Therefore, on the face of it, any information which is provided to the bidder by the target, or by any participating insiders, is information which, if material, may be required to be disclosed by the independent directors in the target company's target's statement, or by the bidder in the bidder's statement. The Panel notes that the bidder's statement and target's statement requirements in the Corporations Act do not include the exceptions to the continuous disclosure obligations of listed entities under ASX Listing Rule 3.1A.

Private equity and other buy-outs

29. Private equity and other buy-out bidders frequently require a higher level of due diligence from target companies. Therefore, these bidders may often have better information about the value of the target company than its target shareholders (and especially so if the bid has participating insiders). Currently the Panel considers that there is no basis for requiring that **all** information provided by the target company, or by participating insiders (whether to private equity bidders and other buy-outs in particular, or other types of bidder) should also be provided to target shareholders. The Panel considers

that the current test of whether or not the information is material is the appropriate test to determine whether or not it should be included in the bidder's or target's statement, rather than requiring **all** information which is provided to private equity bidders and other buy-outs or bidders with insider participation.

30. However, the Panel considers that the higher level of due diligence that private equity bidders and other buy-outs frequently seek, and the greater information that participating insiders may bring, should cause targets and bidders to consider the issue very carefully when deciding what to disclose in their respective bidder's statement and target's statement for private equity, other buy-outs, and insider participation bids.

Management forecasts

31. One of the significant sub-sets of information which is frequently important to bidders (in particular to private equity bidders and other buy-outs because of the level of gearing common in private equity bids and other buy-outs) is forecasts for the target company's future financial, operational and other performance. In almost all cases, participating insiders, especially the management of the target company will have the most complete information about these issues (which is one reason bidders may seek to gain the support of insiders). Bidders who have the support of participating insiders may be able to obtain longer range forecasts than those commonly provided to target shareholders.

32. The target company may be reluctant to disclose its long term forecasts publicly for a number of commercial and strategic reasons or it may choose not to disclose them on the argument that it does not have sufficient reasonable basis to publish the forecasts. The Panel is interested in the issue of whether the board of a target company should be required to reconcile the fact of providing long term forecasts to a bidder with insider participation, which may be material information for rival bidders and shareholders in valuing the target company, with a decision not to disclose them in its target's statement on the basis that the target company does not have a sufficient basis to disclose them publicly.

33. The Panel's current view is that if a target company board provides information to a bidder that includes participating insiders, the Panel should not prescribe whether any part of this information should also be provided by the board of the target company to its shareholders.

34. Questions on disclosure to shareholders:

    (a) Should target company directors be required to release the same information to shareholders as provided to bidders with insider participation? If so, how?

    (b) Alternatively, should a target company directors decline to provide any information to a bidder with insider participation that the target is not prepared to disclose in its target's statement? In particular, how should non-public forward looking information be treated?

(c) Is there any basis for distinguishing private equity bids, or participating insider bids, from other bids in respect to disclosure of information provided to them, or is the materiality of the information the only criterion which should determine the information that bidders and targets disclose, regardless of the identity of the bidder or the nature of the bid?

(d) Should there be express disclosure about the factors listed in paragraph 25 of the draft Guidance Note? Are there other factors that should be expressly required to be disclosed?

(e) Should the identity of any participating insiders involved with a bidder always be disclosed (regardless of the size of any incentives actually or prospectively offered to them or the size of their shareholding in the target)?

(f) Should the bidder, or the target, be required to disclose the background events leading up to a bid which involves participating insiders? If so, when should such disclosure be made?

(g) Should the individual entities behind a bidder always be required to be disclosed in the context of a bid, either under section 602(b)(i) or section 636(1)(a)? Is this information relevant to the decision of target shareholders? Are there circumstances where such disclosure is or is not necessary? For example, where the bid is a cash bid with a 90% minimum acceptance condition?

Issues Not Included in Guidance Note

35. Comment is sought about a number of policy issues on which the Panel currently does not intend to provide guidance in the draft Guidance Note. Set out below is a brief discussion of these excluded issues and why they were excluded.

Anti-competitive practices

36. The Panel considers that practices such as:

(a) attempts by bidders to "corner the market" for legal or financial advisers or debt providers in relation to target companies;

(b) collusion between bidders to reduce takeover competition for a particular target company;

(c) a target's adviser favouring bidders who fund their bid with a debt financing facility offered in a sale process for the target company i.e. a "stapled debt package", where it is offered by the target adviser or its related entity; and

(d) arrangements whereby participating insiders would be precluded from working for an alternative rival bidder, even where the rival bidder was successful in achieving control of the target company,

would be likely to have an adverse effect on the efficient, competitive and informed market for the target securities.

37. However, the Panel considers that consideration of such anti-competitive

practices is outside the scope of the draft Guidance Note and in any event should not be limited to bids involving participating insiders.

38. Anti-competitive practices may involve a bidder inviting other market participants to join with it in the bid consortium or engaging a number of financial or legal advisers to provide advice on the potential takeover transaction[5]. In doing so, the bidder ensures that those participants and advisers will not be available to assist other potential rival bidders. In those circumstances, it would appear to the Panel that such practices are likely to be inimical to the efficient, competitive and informed market for the securities of the target company.

39. Another potentially anti-competitive practice may involve the "locking-up" of participating insiders through financial or other arrangements entered into between them and a bidder.

40. In relation to the "locking-up" of participating insiders, target company boards may be able to mitigate the risk of such behaviours affecting competition for the target company by imposing requirements that ensure that this does not occur.

41. Questions on anti-competitive practices:

    (a) Should the Panel provide separate guidance on the circumstances in which it is likely to view anti-competitive practices as unacceptable?

    (b) Should the Panel give guidance on these issues in the current draft Guidance Note?

    (c) Are the practices described above in relation to bidder collusion and cornering investment banking, legal or debt services common in Australian markets, either in the case of private equity bids, other buy-outs or other types of bids?

    (d) Is there any reason that the Panel should not describe such actions as unacceptable circumstances and make appropriate orders where an application is made and there is evidence that such actions have an adverse effect on the efficient, competitive and informed marked for a target's securities? If so, what types of orders might be effective remedies?

    (e) Should the Panel give any guidance on access for rival bidders to management or other insiders?

Independent Experts

42. Independent experts have specific roles in other jurisdictions in situations where there has been inside participation in a bid. For example:

    (a) Note 4 of Rule 16 of the UK Code requires an independent adviser to the target company to state publicly that, in its opinion, the arrangements

[5] Alternatively, the private equity or buy-out bidder may seek tenders for the (potentially highly lucrative and prestigious) legal or investment banking services in its takeover where it is a condition of submitting a tender that the law firm or investment bank agrees not to work for any other bidder, or the target, in relation to a bid for the target company.

between a bidder and the management of the target company are fair and reasonable; and

(b) in the United States, the target company in a "going private" transaction must file a Schedule 13E-3 document which must state whether the target company reasonably believes the transaction to be fair to all independent shareholders. The Schedule must include any independent reports commissioned in relation to the fairness of the transaction.[6]

43. The Panel does not consider that it should be prescriptive about when there is a role for independent experts where participating insiders are involved in a takeover bid, or what that role should be. The Panel considers it is for the independent directors to determine whether or not an independent expert will assist them to provide target shareholders with the level of analysis of corporate information which shareholders will require (especially given that the IBC may not have full and open access to senior management if they are participating insiders). The independent directors should determine what appropriate independent advice they will require to fulfil all of their duties.

44. Questions on independent experts:

(a) Should the Panel provide specific guidance on whether, and in what circumstances, there is a role for independent experts, especially in bids that involve participating insiders?

(b) Should target companies be required to obtain an independent expert's report on the fairness and reasonableness of a bid where there are participating insiders involved in that bid?

Lock-up devices

45. The Panel considers that the use of lock-up devices in insider participation transactions does not require further guidance than that already provided in the Panel's existing guidance note on lock-up devices.

46. Questions on lock-ups:

(a) Do you think the Panel should provide specific guidance on lock-up devices in the context of insider participation?

Issues not specifically addressed by the Panel

47. Private equity bids and other buy-outs have raised significant discussion in the media and other fora recently, in relation to a wide range of issues. The Panel considers that its jurisdiction properly extends over only a limited sub-set of those issues and areas. The Panel sets out in this section a number of issues and areas which it considers will normally fall outside its jurisdiction or interest and which are not relevant to any guidance the Panel might consider providing.

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[6] This requirement falls short of a formal requirement to engage an independent adviser, or to commission a report – it merely requires the target company to provide to its shareholders any report that it actually does commission on the subject

48. While the Panel recognises that the structure of private equity bids and other buy-outs may increase the risk of insider trading issues arising[7], and that this may affect the efficient competitive and informed market for securities in a target company subject to such a bid, the Panel considers that issues relating to insider trading are better addressed by ASIC or ASX.

49. Similarly, the Panel considers that issues relating to market manipulation, while potentially affecting the efficient competitive and informed market for securities in a target company, are normally better addressed by ASIC or ASX.

50. The Panel considers that its consideration of debt levels of bidders relates only to matters of disclosure to target shareholders. The Panel considers that disclosure of debt levels will be important in relation to:

    (a) ensuring that the bidder has adequate funding for its bid; and

    (b) the level of gearing that the company will have if the bid is successful and the bidder is offering securities as part or all of the consideration for the bid.

    The Panel considers that the Panel's Guidance Note 14 on Funding Arrangements in Takeover Bids, and normal disclosure guidance, adequately address these issues.

51. The Panel considers that general competition issues are more properly addressed by the Australian Consumer and Competition Commission.

52. The Panel considers that issues related to foreign investment by private equity bidders and other buy-outs are more properly addressed by the Foreign Investment Review Board.

53. Questions on insider trading, market manipulation, debt levels, competition issues and foreign investment:

    (a) Is the Panel's approach to insider trading and market manipulation, debt levels, foreign investment and competition issues appropriate?

Timetable and Process

54. **The propositions outlined in the Issues Paper and draft Guidance Note do not represent settled Panel policy.** The questions are intended merely to be prompts for discussion and are not exhaustive of the issues that the propositions may raise. You should feel free to address only selected questions, make general submissions that address an issue as a whole rather than the individual questions, or raise other issues that you consider relevant to the Panel in formulating guidance, where it considers appropriate, on specific issues arising from insider participation in control transactions.

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[7] It is suggested that insider trading issues may arise with private equity bids and other buy-outs because private equity bidders and other buy-outs typically:
(a) use a greater number of lenders because of their higher levels of gearing than trade or other buyers; and
(b) require longer periods of due diligence to satisfy their lenders because of their higher levels of gearing.

55. The Panel is very interested in any views as to whether any other issues raised in this Issues Paper, or not raised, are issues which are more appropriately dealt with in relation to all takeover bids in a Guidance Note related to the particular issue rather than in any guidance on insider participation in bids.

56. Submissions are sought in response to the propositions and the questions by 5.00 pm on Friday, 6 April 2007.

57. Please send submissions to the Panel, attention Judy Yeung (Tel: (03) 9655 3553; Email: judy.yeung@takeovers.gov.au), Nigel Morris (Tel: (03) 9655 3501; Email: nigel.morris@takeovers.gov.au) and Bruce Dyer (Tel: (03) 9655 3560; Email: bruce.dyer@takeovers.gov.au).

58. Following receipt of public submissions in regard to this Issues Paper, the Panel will consider whether it is appropriate to issue a Guidance Note based on the draft Guidance Note and considering the submissions received. It is Panel policy to review Guidance Notes periodically after they have been issued.

59. The Panel's policy is that all submissions received may be posted on the Panel's website, or otherwise made public, unless the person making the submissions specifically requests that they be confidential.