REGULATORY GUIDE 145

Collateral benefits—Takeovers funding and pre-bid purchases

Chapter 6 — Acquisition of shares

Issued 1/9/1999

***Editor's note**: This guide was updated in April 2008 to remove obsolete references to NCSC documents.*

From 5 July 2007, this document may be referred to as Regulatory Guide 145 (RG 145) or Policy Statement 145 (PS 145). Paragraphs in this document may be referred to by their regulatory guide number (e.g. RG 145.1) or their policy statement number (e.g. PS 145.1).

Note: The class orders referred to in this guide cannot be issued until an application has been received by an affected party (see s728 and s730). For any queries in relation to class order relief, please contact Allan Bulman on (03) 9280 3307.

What this guide is about

RG 145.1 This guide discusses class order relief from the prohibition on providing collateral benefits before and during a takeover bid (s698). In particular it provides guidance to market participants on:

A Funding a takeover

see RG 145.3–RG 145.30

B Acquiring a pre-bid stake

see RG 145.31–RG 145.49

C Enforcement of s698

see RG 145.50–RG 145.54

RG 145.2 The Corporate Law Economic Reform Program Bill 1998 proposes substantial reform of Chapter 6 of the Law. guidewill be reviewed if and when this Bill is enacted.

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Relief for underwriting and placements

RG 145.3 We are prepared to give relief by class order to allow a bidder to offer and enter into agreements for underwriting and placements[1] with persons ("underwriters"). These agreements must be made on a bona fide fully priced basis. This class order will apply where the bidder lodges a written statement stating that it wants the class order to apply to it.

RG 145.4 The class order will require that an agreement to provide underwriting or a placement will terminate if the bidder does not receive, within 5 days of the agreement being entered into, a written statement from the underwriter stating that it wants the conditions referred to in RG 145.5 to apply to it.

RG 145.5 An underwriter must not accept the bidder's takeover in relation to shares in which it has a disposal relevant interest, or sell those shares if there is reason to believe that the bidder is the ultimate purchaser, unless:

(a) the offers under the takeover have been open for acceptance for three weeks; and

(b) the underwriter reasonably believes that the bidder's takeover provides the best consideration on offer.

RG 145.6 The class order will impose the following conditions on the bidder:

(a) In selecting underwriters, the bidder does not discriminate between them by taking into account a potential underwriter's shareholding in the target.

(b) Underwriting is not offered as an inducement to accept offers under the takeover.

(c) Entering into agreements for underwriting or placements is a part of the underwriter's ordinary business.

[1] "Underwriting" and "placements" are defined in Key Terms.

(d) When entering into a funding agreement with an underwriter, the bidder has reasonable grounds for believing that the underwriter has a disposal relevant interest in the target of less than 5% of the bid class shares in the target.

(e) The bidder has reasonable grounds for believing that the underwriters, who have entered into funding agreements with the bidder, do not have in aggregate a disposal relevant interest in 20% or more of the bid class shares in the target.

(f) The bidder must not knowingly purchase any shares in the target which the underwriter has a disposal relevant interest in, between the time:

(i) when the bidder first makes an offer to the underwriter to enter into a funding agreement; to

(ii) when the bidder receives the notice in writing, referred to in RG 145.4 from the underwriter.

(g) A bidder may only knowingly purchase any shares in the target in which the underwriter has a disposal relevant interest if the bidder has no reason to believe that the purchase would result in the underwriter contravening the conditions stated in RG 145.4.

(h) The bidder must lodge copies of all the statements signed by underwriters referred to in RG 145.5.

Relief for rights issues

RG 145.7 We are prepared to give relief by way of class order to allow a bidder to fund its takeover by way of a rights issue of shares, irrespective of whether any of its shareholders are shareholders in the target. This class order will apply where the bidder lodges a written statement stating that it wants the class order to apply to it.

Relief for funding by way of a prospectus

RG 145.8 We are prepared to give relief by way of class order to allow a bidder to fund its takeover by issuing shares under a prospectus, provided shareholders in the target are not favoured in any way in the allocation policy under the prospectus. This class order will apply where the bidder lodges a written statement stating that it wants the class order to apply to it. The class order will not apply to an institutional offer, underwriting or subunderwriting of the offer.

Underlying principles

RG 145.9 Finkelstein J in *Aberfoyle v Western Metals* (1998) 28 ACSR 187, 221–222, stated that s698 would be contravened if an issue of shares to a target shareholder by a bidder constituted benefits which are "connected with or have the potential to influence or induce" a target shareholder to sell its shares to the bidder or accept the bid. On the facts of that case, Finkelstein J held that advantages, such as purchasing a large parcel of shares off market, were benefits for the purposes of s698.

RG 145.10 Whether an issue of shares to a target shareholder constitutes a contravention of s698 under Finkelstein J's formulation is a question of fact. It is possible that a bidder entering into an underwriting agreement with a target shareholder may contravene s698.

RG 145.11 Part of the policy rationale for s698 is that collateral benefits should not be offered to target shareholders which may induce them to accept the bid. This proposition is supported by the fourth Eggleston principle that, "as far as practicable, all shareholders of a company have reasonable and equal opportunities to participate in any benefits accruing to shareholders under any proposal under which a person would acquire a substantial interest in the company." (See s731(d).)

RG 145.12 However it has become apparent following Finkelstein J's judgment that s698 may restrict the ability of bidders to fund their takeovers by way of underwriting or placements. This could have the effect of unnecessarily deterring takeover bids.

RG 145.13 Our primary aim in providing relief in this instance is to:

(a) remove, as far as practicable, the restriction s698 may have on the issue of shares to target shareholders; and

(b) ensure that no commercial benefits are given to target shareholders which may materially influence their decision whether or not to accept the bid[2].

[2] Receiving an underwriting fee or an underwriting discount are common in commercial underwriting and by no means necessarily lead to the conclusion that the underwriting is not bona fide fully priced.

Explanations

Applicability of class order relief

RG 145.14 Class order relief will only apply where the bidder has lodged a written statement stating that it wants to have the relevant class order to apply to it. This requirement ensures that:

(a) bidder can rely on the class order as a defence to s698; and

(b) we will have a right of action against the bidder if they contravene any conditions of the class order.

RG 145.15 The requirement in RG 145.4 ensures that we can take action against an underwriter who contravenes the requirements, relating to accepting a bid or selling its shares in the target, referred to in RG 145.5. We would not offer relief, as described in RG 145.3–RG 145.6, unless we could impose these requirements.

Relief for underwriting and placements

Conditions on underwriters

RG 145.16 One way to reduce the risk that the outcome of the bid will be determined by target shareholders being offered underwriting or placements, is to restrict the target shareholder's ability to accept the bid. The conditions imposed on the underwriters, as referred to in RG 145.5, have two effects:

(a) they directly reduce the likelihood that the underwriter will accept the bidder's takeover because of an inducement; and

(b) they remove to some extent the incentive for a bidder to offer an inducement in the form of underwriting or a placement, as there is a possibility that its bid will not be accepted if a rival bid is announced.

RG 145.17 The condition in paragraph (a) of RG 145.5 means that an underwriter cannot accept the bid, or sell its shares if it has reason to believe that the bidder is the ultimate purchaser, for the first three weeks that the bid is open for acceptance. In general, three weeks is sufficient time for a rival bidder to announce its bid for the same class of shares.

RG 145.18 The condition referred to in paragraph (b) of RG 145.5 means that an underwriter:

(a) can only accept the bid; or

(b) sell its shares if it has reason to believe that the bidder is the ultimate purchaser;

if it reasonably believes that it offers the best consideration of any bid in the same class of shares which has been announced.

RG 145.19 An underwriter will comply with this requirement if it undertakes reasonable due diligence to satisfy itself that the bidder's takeover does offer the best consideration on offer. In assessing which consideration is best, offerees are entitled to consider conditions affecting each offer and their respective likelihoods of success, as well as the value or amount of the consideration. However, they must not take into account collateral transactions.

Conditions on the bidder

RG 145.20 The condition described in paragraph (a) of RG 145.6 will be contravened if there is evidence that the bidder or its advisers "targeted" shareholders in the target to be underwriters. The condition described in paragraph (b) of RG 145.6 will be contravened if there is any evidence that the bidder or its advisers intended to offer underwriting or placements to induce target shareholders to accept the bid.

RG 145.21 If underwriting or placements are offered to persons who do not participate in these activities as a part of their ordinary course of business, the risk that the underwriting or the placement may be offered as an inducement to accept the bid may increase. Therefore class order relief will not permit underwriting or placements to be offered to those persons (paragraph (c) of RG 145.6).

RG 145.22 All things being equal the greater an underwriter's shareholding in the target, the greater the risk that underwriting or placements may be offered to that person as an inducement. A bidder offering underwriting or placements to a number of target shareholders may, if the underwriting or placements have the capacity to induce those shareholders to accept the bid, affect the success of the bid.

RG 145.23 We are of the view that there needs to be an upper limit on the shareholding an underwriter has in the target and the global shareholding in the target for all the underwriters who enter into funding agreements with the bidder. Given the requirements imposed on the underwriters referred to in RG 145.5, we are of the view that the 5%/20% conditions referred to in paragraphs (d) and (e) of RG 145.6 limit sufficiently the risk that underwriting or placements will be offered as an inducement to target shareholders to accept the bid.

RG 145.24 By way of an example, we are prepared to grant case by case relief without the requirements referred to in RG 145.5 if the

substantial shareholding condition referred to in paragraph (d) of RG 145.6 was reduced to a 1% disposal relevant interest.

RG 145.25 If a bid is for all the voting shares in the target and a potential underwriter has not lodged a substantial shareholder notice in relation to the target, the bidder will normally be able to satisfy itself that the target has less than a 5% disposal relevant interest in the bid class shares in the target.

RG 145.26 We consider that it is reasonable to limit the bidder's ability to purchase an underwriter's shares in the target while a bidder's offer to the underwriter for underwriting or placements is open for acceptance (see paragraph (f) of RG 145.6). Otherwise there would be the possibility that relief could be abused.

RG 145.27 The condition in paragraph (g) of RG 145.6 complements the requirements imposed on the underwriter in RG 145.5.

Disposal relevant interest

RG 145.28 It is more likely that an underwriter will be able to direct its related companies to accept the bid for those shares it has control over disposal (a "disposal relevant interest"). It is also arguably unreasonable to count, for the purpose of the 5%/20% condition or the restrictions on an underwriter accepting the bid, those shares which it does not have control over disposal. Therefore we intend to exclude from the class order referred to in RG 145.3–RG 145.6, for the purposes of determining an underwriter's disposal relevant interest, the operation of s30(2), 30(5), 31(1), 33, 34 and 35 of the Law.

Relief for rights issues

RG 145.29 We are of the view that a rights issue of securities by the bidder to its shareholders, which complies with ASX Listing Rule 7.7, would have less of a tendency to induce the bidder's shareholders, who were also target shareholders, to accept the bid. This is because the issue is unrelated to existing shareholdings in the target.

Relief for funding by way of a prospectus

RG 145.30 An offer to subscribe for shares under a retail (as opposed to an institutional) offer in a prospectus is open to target shareholders and the public at large. There is a risk that a bidder could undertake to offer a benefit to target shareholders by means of a prospectus issue. However the risk of this happening is minimised if target shareholders are not favoured in the allocation policy under the prospectus.

B Acquiring a pre-bid stake

Our policy

RG 145.31 We are prepared to give relief by class order to permit certain crossings to be in the "ordinary course of trading" for the purposes of s698(5).

RG 145.32 The relief will apply to an acquisition of shares:

(a) during the takeover period and where a bidder proposes to make a takeover bid within the next four months;

(b) made at any time on the Exchange (excluding the Pre-Opening Phase, the Enquire Phase, the After Hours Adjust Phase and the Adjust Phase);

(c) made by way of a crossing (but not a special crossing) which complies with the relevant ASX Business Rule;

(d) which is arranged solely by a broker(s) and is not prearranged between the bidder and the seller; and

(e) where the bidder and the seller are indifferent as to one another's identities.

Underlying principles

RG 145.33 Since the decision by Finkelstein J in *Aberfoyle v Western Metals* (1998) 28 ACSR 187, there has been uncertainty in the market as to whether a crossing is in the "ordinary course of trading" for the purposes of s698(5). Subsection 698(5) is an exception to the prohibition against providing collateral benefits (generally s698). Therefore there is uncertainty as to whether a broker acting for the bidder can accumulate a pre-bid stake by crossing shares on the ASX.

RG 145.34 We are of the view that this uncertainty is overstated. Subject to certain provisos, a crossing can be in the "ordinary course of trading". However we are prepared to give class order relief to promote certainty. Relief is intended to reflect the judicial interpretation of the phrase.

Explanations

"Ordinary course of trading"

RG 145.35 The phrase "at an official meeting of a stock exchange[3] in the ordinary course of trading on the stock market of that stock exchange" (known as "the ordinary course of trading") is used in the following sections of the Corporations Law:

(a) s698(5) — as an exception to the prohibition against offering collateral benefits outside a takeover scheme or takeover announcement;

(b) s620 — which allows a bidder to trade in "the ordinary course of trading" during a takeover scheme if the bid is unconditional or if it is only subject to the prescribed occurrences;

(c) s677(1) — which states that an acquisition in "the ordinary course of trading" during a takeover announcement may be for a higher price than offered under the announcement, subject to s677(2);

(d) s257B(6) — as part of the definition of on-market buy-back; and

(e) s1030(1A) — which is an exception to s1030.

RG 145.36 For the purposes of Chapter 6, the expression "ordinary course of trading" is partially defined as not including special crossings (s604).

Crossings

RG 145.37 A crossing is essentially a transaction where the broker acts for both the buyer or the seller (see the definition in Key Terms).

RG 145.38 In relation to crossings during Normal Trading and the Closing Phase, the ASX Business Rules and the SEATS Reference Manual impose the following restrictions:

(a) where a broker wants to cross where there is already a market in the shares, it is required to deal with other buyers and sellers on a price priority basis; or

(b) where a broker wishes to cross where there is not a market in the shares, it is required to make a market in the shares (for a minimum of one share) and wait for 10 seconds before it can undertake any crossing.

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[3] The ASX Business Rules (Rule 2.3.1(2)) define "Official Meeting" as commencing at the beginning of the Pre-Opening Phase and concluding immediately prior to the beginning of the Enquire Phase.

Cases on the phrase "ordinary course of trading"

RG 145.39 The majority of the High Court in *Sagasco Pty Ltd and Anor v Magellan Petroleum Australia Ltd* (1993) 177 CLR 508 at 518 stated that where a pre-bid acquisition of shares is made and the offers under the bid are made at the same price, mere early payment does not constitute a benefit. They stated that "earlier payment means relinquishing the shares and the rights that go with them at an earlier date." The majority of the High Court did not explicitly consider whether an unconditional pre-bid acquisition before a conditional bid constituted a benefit.

RG 145.40 Two recent single judge decisions in the Supreme Court of New South Wales and the Federal Court have held that an unconditional pre-bid acquisition before a conditional bid did constitute a benefit in those cases (see Santow J in *Boral Energy Resources Ltd v TU Australia (Queensland) Pty Ltd* (1998) 28 ACSR 1 and Finkelstein J in *Aberfoyle v Western Metals* (1998) 28 ACSR 187). We consider that these cases state a policy rationale which we need to take into account when considering relief from s698.

RG 145.41 Several decisions have interpreted the phrase "ordinary course of trading". Gowans J in *AG (Vic) v Walsh's Holdings Ltd* (1973) VR 137, 144 stated that the phrase "carries overtones of an anonymous competitive bargaining in an open forum according to the common and usual course of that activity and without unusual features in the bargaining suggestive of collateral objectives". Another case has suggested that trading does not necessarily need to be anonymous. However trading must be conducted "indifferently to the identity of the principals standing behind the brokers who conduct the dealings and incur their own liabilities in respect of them" (see *ICAL v County Natwest Securities* (1988) 39 NSWLR 214, 247).

RG 145.42 Finkelstein J in *Aberfoyle v Western Metals* adopted Gowans J's formulation and decided that it could be applied to trading on SEATS. He found that as:

(a) the parties had negotiated the crossings "well away from any stock market"; and

(a) the institutions did not authorise the broker to sell their shares to any other party besides the bidder,

the trading was clearly not in the "ordinary course of trading".

Our view on the meaning of "ordinary course of trading"

RG 145.43 It would appear that a number of market participants have taken Finkelstein J's judgment as stating that the "ordinary course of trading" exception does not include crossings. This has lead to some brokers refusing to undertake crossings where the transactions are required, for the purposes of the Corporations Law, to take place in the "ordinary course of trading". We have also been informed that some brokers acting for bidders have felt it necessary to decline to act for their other clients in the target's shares. This has led to the market guessing that the broker is acting for a bidder acquiring a pre-bid stake.

RG 145.44 We believe in a takeover situation that a broker acting for a bidder can undertake crossings as long as:

(a) there is no prearrangement of the transactions by the bidder and seller; and

(b) the bidder and the seller are indifferent to one another's identities[4].

RG 145.45 Trading may be in the "ordinary course of trading" if it occurs during Normal Trading or the Closing Phase.

Class order relief

RG 145.46 We are prepared to give relief by class order to allow crossings by a broker acting for the bidder where we believe they would be permitted under the judicial interpretation of the expression "in the ordinary course of trading" under s698(5).

RG 145.47 We consider that the conditions referred to in paragraph (e) of RG 145.32 (indifference) may be contravened if the bidder, the broker or an associate of the bidder or the broker communicates to the seller either:

(a) the identity of the bidder; or

(b) the terms of the bidder's takeover offer.

RG 145.48 We are of the view that relief should only be given for crossings which occur during periods of trading where there is a reasonable degree of activity. Therefore in consultation with the ASX, we have excluded crossings undertaken in the Pre-Opening Phase, the Enquire Phase, the After Hours Adjust Phase and the Adjust Phase. Another reason for this carve out is that the rules referred to in

[4] Crossings constitute normal market activity and are capable of being in the "ordinary course of trading" (see *Jones v Canavan* (1972) 2 NSWLR 236).

RG 145.38 only apply to crossings during Normal Trading and in the Closing Phase.

RG 145.49 As the same uncertainty does not appear to exist in relation to ordinary market trading, we intend to limit this relief to crossings which comply with the relevant ASX Business Rule.

C Enforcement of s698

RG 145.50 We hold the view that s698 and the equality of opportunity principle are important concepts in regulating takeovers. We will continue to monitor bids to ensure compliance with the letter and spirit of Chapter 6.

RG 145.51 We will consider taking injunctive, or other action, against parties which contravene s698 and operate outside the class order or other relief. We will also review the suitability for licensing for any licensed person who contravenes, or helps another person contravene s698.

RG 145.52 We will consider carving out a company from the definition of an underwriter in the class order referred to in RG 145.3 to RG 145.6 if it:

(a) acted as an underwriter where a bidder relied on the class order; and

(b) did not comply with the requirements referred to in RG 145.5.

RG 145.53 We are likely to consider whether unacceptable circumstances have occurred (s733(1)) and may refer the matter to the Corporations and Securities Panel if a bidder:

(a) does anything which is not in the spirit of the class order which it relies on; or

(b) uses class order relief in a way which is contrary to the Eggleston principles (in particular the equality of opportunity principle).

RG 145.54 For example we would consider referring the following matters to the Corporations and Securities Panel:

(a) underwriting or placements, either within or outside the terms of the proposed class order, which are clearly uncommercial and would constitute a benefit; and

(b) issues to target shareholders under a prospectus where it is clear that the prospectus was a sham designed to give certain target shareholders benefits.

Key terms

RG 145.55 In this guide, a reference to:

"Adjust Phase" is defined in ASX Business Rule 2.1.

"Adviser" does not include a person only supplying services to the principal as a broker.

"After Hours Adjust Phase" is defined in ASX Business Rules, 2.1 and 2.6.7.

"Broker" means a securities dealer who is a member of the Exchange.

"Crossing" as defined in the ASX Business Rules is "where a broker acts:

(a) on behalf of both buying and selling clients; or

(b) as principal as:

(i) buyer and the seller is a client of the broker; or

(ii) seller and the buyer is a client of the broker."

The rules relating to crossings can be found in ASX Business Rule 2.7.

"Disposal relevant interest" is a relevant interest disregarding s30(2), 30(5), 31(1), 33, 34 and 35 of the Law.

"Enquire Phase" is defined in ASX Business Rules 2.1 and 2.6.8.

"Institution" is defined broadly to mean companies in the financial service sector which participate in large issues of shares.

"Placement" means an issue of securities which would constitute an excluded issue under s66(2)(a) of the Law, paragraph 7.12.05(a) of the Corporations Regulations or paragraph 7.12.05(e) of the Corporations Regulations.

"Pre-Opening Phase" is defined in ASX Business Rules 2.1 and 2.6.2.

"Principals" is taken to include their associates, advisers and advisers' associates.

"Rights issue" means a pro rata issue of shares which complies with ASX Listing Rule 7.7.

"underwriter" means a target shareholder who is offered underwriting or a placement by the bidder.

"Underwriting" is broadly defined to include the following:

(a) Assuming the risk that an offer of shares is not taken up by the intended investors, either under a prospectus or otherwise. This assumption of the risk can either be carried out by:

  (i) initially subscribing for the entire issue and on selling them to investors who later subscribe for the shares;

  (ii) initially subscribing for the entire issue and then renouncing part or all of its allotment in favour of members of the public who take the securities on the basis of a prospectus; or

  (iii) more traditionally, by agreeing to subscribe for, or procure subscriptions for, securities not otherwise subscribed for under a specific offer (see generally RG 61.2–RG 61.9).

(b) Subunderwriting — which is assuming part of the risk of a main underwriter.

Related information

RG 145.56

Headnotes

s698, Collateral benefits, underwriting, placements, crossings, pre-bid stakes, ordinary course of trading

Regulatory guides

RG 35 *Collateral benefits in takeovers*

Legislation

Chapter 6, s698

Cases

Sagasco Pty Ltd and Anor v Magellan Petroleum Australia Ltd (1993) 177 CLR 508

Boral Energy Resources Ltd v TU Australia (Queensland) Pty Ltd (1998) 28 ACSR 1

Aberfoyle v Western Metals (1998) 28 ACSR 187

AG (Vic) v Walsh's Holdings Ltd (1973) VR 137

ICAL v County Natwest Securities (1988) 39 NSWLR 214

Jones v Canavan (1972) 2 NSWLR 236

Reports

Company Law Advisory Committee, *Report to the Standing Committee of Attorneys-General on Disclosure of Substantial Shareholdings and Takeovers*, Victorian Government Printer, 1969 (Eggleston Report).

Media and information releases

[MR 98/315], [IR 99/13]