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Takeovers Panel Reissues Guidance Note on Lock-up Devices

On 13 November 2007, the Takeovers Panel (“**Panel**”) reissued Guidance Note 7 regarding its approach to lock-up devices in control transactions (“**Guidance Notice**”). Lock-up devices refer to arrangements entered into by targets to encourage or facilitate a takeover bid and include arrangements such as break fees, asset lock-ups, no-talk agreements and no-shop agreements. Whilst the Panel’s guidance notes are not binding, they provide guidance as to when the Panel is likely to make a declaration of “unacceptable circumstances” pursuant to section 657A of the Corporations Act 2001 (Cth) (“**Act**”).

The Panel’s recent amendments to the Guidance Note are to reflect its experience concerning lock-up devices since the last version of the Guidance Note was issued in February 2005. The Panel has advised that its changes are not substantive and do not involve any change in policy and, accordingly, the updated Guidance Note has not been issued in draft form. The amendments include:

1. an increased focus on the use of multiple lock-up devices in a single control transaction and the Panel’s concern with the overall effect of lock-up arrangements;
2. providing guidance on agreements affecting dealings with rival bidders;
3. inserting references to recent decisions to offer further guidance on the Panel’s application of its policy; and
4. clarifying that the principles contained in the Guidance Note will apply to any arrangement which has the effect of fettering the actions of a target, a bidder or a substantial shareholder. For instance, the policies contained in the Guidance Note can apply to schemes of arrangement, “backdoor” listings and other control transactions requiring shareholder approval.

Overview of Guidance Note 7

The Panel will not treat lock-up devices as prima facie unacceptable. Rather, the Panel examines the overall or likely effect of the lock-up arrangements on current and potential bidders, shareholders and the market whilst taking into account the purpose of Chapter 6 of the Act. A lock-up arrangement that prevents the acquisition of a target occurring in an efficient, competitive and informed market will normally result in a declaration of unacceptable circumstances.

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In negotiating lock-up arrangements, the target and the bidder should normally ensure that the arrangements do not have:

- a significant deterrent impact on the competition for control of the target or current or potential counter-bids; or
- a substantial coercive effect on the shareholders of the target in respect of their assessment of the bid or any current or potential counter-bids.

Break fees

One of the most common lock-up devices are break fees. A break fee is generally a payment that must be made by the target to a bidder or potential bidder if the bid fails or is rejected by target shareholders. The Panel takes the view that a break fee should not normally exceed 1% of the equity value of the target. In this context, the “equity value” of the target is the total combined value of all classes of equity securities issued by the target as at the date the bid is announced, having regard to the value of the consideration under the bid.

No-talk agreements

A no-talk agreement involves an arrangement whereby the target agrees not to negotiate with any competing bidders including bidders that make unsolicited approaches to the target. The Panel considers that the obligations of a target under a no-talk agreement should cease once the bid has been made public and be subject to the fiduciary duties of the target’s directors.

For instance, in *Magna Pacific Holdings Limited 02* [2007] ATP 03, the Panel examined a no-talk agreement which only allowed the target’s directors to respond to other bids where it had obtained legal advice to the effect that failing to respond to such bids “*would*” breach their fiduciary duty. The Panel considered that this exception was of little practical use and would have been more appropriate if it extended to where the directors had obtained legal advice to the effect that failing to respond to a bid “*would be likely*” to breach their fiduciary duties.

Variations of no-talk agreements include agreements between a target and a bidder that prevent the target from:

- (a) providing sensitive corporate information about the target’s business to other potential bidders; or
- (b) allowing other potential bidders to conduct due diligence on the target.

No-shop agreements

No-shop agreements are a less stringent form of no-talk agreements. Under a no-shop agreement, a target agrees with a bidder or potential bidder from actively soliciting other takeover bids from third parties. Unlike no-talk agreements, generally, the Panel considers that no-shop agreements do not require a fiduciary exemption. Nevertheless it is advisable that no-shop agreements contain a period of restraint which is reasonable. This usually means that the no-shop agreement should end when the bid is announced. However, the Guidance Note states that a no-shop obligation may extend into the bid period where it is justifiable having regard to the advantages that the agreement offers to shareholders of the target.

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Asset lock-ups

An asset lock-up involves an agreement where a target grants an option to a potential acquirer to purchase a particular asset or assets of the target. An asset lock up is also referred to as a “crown jewel” lock up because the target’s asset, the subject of the lock up arrangement, is often the target’s primary asset. In its Guidance Note, the Panel recommends that asset lock-up agreements should be negotiated on an arms length basis, should be at fair value and should not negatively impact the amount or distribution of benefits to the target’s shareholders in relation to the takeover.

Remedies

If the Panel makes a finding of unacceptable circumstances, it may make a range of orders under section 657D(2) of the Act. For instance, the Panel may make any order that it thinks appropriate to ensure that a takeover bid or proposed take over bid proceeds in a way that it would have proceeded if the unacceptable circumstances had not occurred.

In addition to considering the Guidance Note in any proposed takeover negotiations, directors of both targets and bidders must ensure that they comply with other various requirements under the Act such as directors’ duties, financial assistance and related party transaction issues.

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