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Recent Developments and Trends in Cross Border Mergers, Acquisitions and Listings

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SUMMARY

The concurrent regulation of a cross border deal by conflicting Australian and foreign law can have a profound impact upon deal feasibility, logistics and implementation. This paper outlines: (a) the basic elements of popular cross border mergers and acquisitions structures (being takeovers, schemes and dual listed companies (DLCs); (b) the circumstances in which Australian law will regulate cross border merger and acquisitions activity; (c) how and when conflicts between Australian law and foreign law in the cross border context are most likely to arise, and the way in which such conflicts can influence deal structure and timing; (d) recent responses of Australian and foreign regulators to the problem of conflicting legal regimes; and (e) how concepts from "foreign" cross border mergers and acquistions cultures have been experienced in the Australian market, and in particular the response of Australian regulators to these concepts in the Australian legal context.

The first part of this paper briefly discusses the comparative features of structures for "cross border" mergers and acquisitions. The second part discusses the legal and regulatory issues particular to each of these structures in the "cross border" context.

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TAKEOVERS, SCHEMES AND DLCs

The utilisation of a takeover or scheme of arrangement to acquire control of an Australian listed entity is partially a matter of legal necessity, and partially a matter of commercial benefit. The legal necessity arises from Ch 6 of the *Corporations Act* 2001 (Cth), which prohibits the acquisition of a relevant interest which results in voting power above 20 percent in an Australian listed entity[1] unless the method of acquisition falls within a permitted exception.

Although a takeover or scheme of arrangement is merely one of several permitted methods of acquiring control, these are the mechanisms that are most commonly used to acquire 100 percent.[2] The commercial benefit arising from a takeover or scheme of arrangement is that both procedures provide a method to compulsorily acquire the shares of dissenting shareholders once a certain level of ownership or approval is achieved: a benefit not necessarily otherwise available to an offeror under the common law.

In contrast there is no legislatively prescribed method by which a DLC structure may be implemented. The two companies which make up the DLC remain separate legal entities, and do not acquire an ownership interest in the other. The "merger" is economic rather than legal, achieved through contractual arrangements which are structured such that the DLC operates as a single economic unit. This is not to say that legal compliance issues do not affect the establishment of a DLC: at the very least there will be a need for shareholder approval to make the necessary amendments to the constitutions of both companies.

Summary Features of a Takeover

Under Australian law, a takeover bid can be either a "market" or "off market" bid.

Conditionality

In a market bid, the bidder must stand in the market with an unconditional offer to buy all bid class securities for the length of the offer period (subject to certain very limited withdrawal rights).[3] In contrast, an off market bid may be conditional, and may be for all or a proportion of the bid class securities (although if for a proportion, the bid must be for the same proportion of each holder's securities).

1 Although Ch 6 of the *Corporations Act* also regulates the acquisition of control of unlisted companies with more than 50 members (see s 606(1)(a)(ii)), such a scenario is of less relevance in a cross border M&A context and has not been dealt with in this paper.
2 Other methods include selective capital reductions, selective buy backs and s 414 proceedings.
3 See s 652C, *Corporations Act*, "prescribed occurrence".

Once the bid is unconditional the bidder has no ability to refuse to accept securities tendered by accepting shareholders. An unconditional takeover bid therefore carries the risk that the bidder may acquire less than a controlling interest in the target. As the practice of Australian institutions is not to accept into a bid until it is unconditional (and the date for payment of the consideration is certain), a bidder may be forced to waive a minimum acceptance condition prior to its fulfilment to break the impasse.

Documentation and disclosure

The documentation that must be prepared for each type of takeover bid is the same. The bidder is required to produce a bidder's statement which contains information about a list of matters specified in s 636(1)(a) to (l), and more generally any other information that is material to the making of the decision by a holder of bid class securities to accept an offer under the bid and is known to the bidder: s 636(1)(m). The target is required to produce a target's statement which includes all the information that holders of bid class securities and their professional advisers would reasonably require to make an informed assessment whether to accept the offer under the bid. Material new information arising during the course of the bid, or information which is required to correct a materially misleading matter in the original bidder's or target's statement must be released to the market, the Australian Securities & Investments Commission (ASIC) and the target or bidder as soon as practicable in the form of a supplementary bidder's or target's statement (as the case may be).

Cooperation

A takeover bid does not require the cooperation of the target in order to be successful, although obtaining a recommendation from the target's board increases the chance that the shareholders will find acceptable the offer to acquire their shares.

Compulsory acquisition

A bidder is entitled to compulsorily acquire the shares of dissenting shareholders if during, or at the end of, the offer period the bidder and its associates have relevant interests in at least 90 percent (by number) of the securities in the bid class and the bidder and its associates have acquired at least 75 percent (by number) of the securities that the bidder offered to acquire under the bid (excluding any securities in which the bidder or its associates already had a relevant interest).[4] In practical terms, provided the bidder and its associates held less than

[4] See Class Order 01/1544, which clarifies the terms of s 661A(1)(b)(ii), *Corporations Act* (the 75% test).

60 percent relevant interest at the start of the bid the 75 percent test will be fulfilled prior to achieving 90 percent voting power.

Summary Features of a Scheme of Arrangement

Under Australian law, a scheme of arrangement is a statutory procedure whereby a company may come to a binding compromise or arrangement with its creditors or members upon obtaining court approval and approval from the requisite majority of the creditors or members. In the merger context, a scheme of arrangement may be used to bind the members of a company to "exchange" their shares for securities in another entity, to which some or all of the original company's assets or liabilities may also be transferred.[5]

The statutory scheme of arrangement is available for a "Part 5.1 body", which is defined as a company, a registrable Australian body or a foreign company that is registered under the *Corporations Act*. The use of a scheme of arrangement to effect a merger involving a foreign company can involve interesting conflict of laws issues, particularly if the law of the foreign company's domicile is inconsistent with the Australian scheme of arrangement procedure. For instance, under Australian law there is no "blending" of legal identities as a result of the scheme: the companies involved will remain separate and distinct, although their capital and assets may be restructured or redeployed.[6]

Conditionality

A scheme of arrangement between a company and its members must be approved by a majority (by number) of members present and voting at the meeting, holding at least 75 percent of votes cast on the resolution. The scheme must then be approved by the court, on such conditions as it thinks just.

A scheme of arrangement may be structured as an "all or nothing" proposal: if the requisite approvals are obtained, the scheme is implemented but if the requisite approvals are not obtained the whole proposal lapses. It therefore does not carry the risk of acquiring a minority interest which may arise once a takeover bid becomes unconditional.

[5] Prior to the taxation changes in the 1990s in relation to schemes, the practice was to cancel shares in the target and reissue to the acquirer, rather than transfer.

[6] Compare the effect of a merger under the Delaware General Corporation Law, where the target is merged "with and into" the acquirer, following which the separate corporate existence of the target ceases and a "surviving corporation" continues which succeeds to all the rights, properties, liabilities and obligations of the target.

Documentation and disclosure

It is usual for the company proposing the scheme (the target) and the prospective acquirer or merger partner to enter into an implementation agreement with respect to a scheme, governing the rights and obligations of the parties until the scheme is either rejected by the target's members or implemented.

The company proposing the scheme must send to each member an explanatory statement explaining the effect of the scheme and, in particular, stating any material interests of the directors and the effect on those interests of the compromise or arrangement in so far as that effect is different from the effect on the like interests of other persons, and setting out any other information that is material to the making of a decision by a member whether to approve the scheme, being information that is within the knowledge of the directors and has not previously been disclosed to the members.

Cooperation

To have any chance of success a scheme of arrangement requires the cooperation of the target company, which has the obligation for (and control of) preparing the scheme documentation.

Compulsory acquisition

As dissenting shareholders are bound by the court order approving the scheme, it is not necessary to institute a separate compulsory acquisition procedure to effect a scheme of arrangement.

Summary Features of a DLC

The key features of a DLC are as follows:

- the two companies remain separate legal entities and retain individual stock exchange listings;
- shareholders retain their existing shares, but after the DLC structure is implemented these shares represent an equal economic interest in the combined assets of both companies;
- shareholders have equivalent dividend, capital and voting rights on a per share basis, effected through contractual arrangements and amendments to each company's constitution;
- the two companies are managed as one, having regard to the interests of the shareholders of both companies;

- the two companies are domiciled in different capital markets, giving the flexibility to raise capital in either jurisdiction.

CROSS BORDER MERGER & ACQUISITION REGULATION

Australian securities law will only regulate cross border merger and acquisitions (M&A) activity where the relevant activity involves:

- the acquisition of control of an Australian incorporated or registered listed entity;[7]
- the offer of securities to persons within Australia at the time the offer is made.

The circumstances in which foreign law will regulate cross border M&A activity which is also regulated by Australian law will vary depending on the relevant foreign law involved and the circumstances of the target and acquirer, but may include circumstances where:

- the target has securities registered under foreign legislation or a foreign exchange (for instance the target has securities registered under s 12 of the United States *Securities Exchange Act* 1934 (Williams Act));
- the bidder or its parent has securities registered under foreign legislation (for instance a bidder has securities registered under s 12 of the Williams Act: see r 13e-4 promulgated under the Williams Act);
- the relevant M&A activity involves making a takeover offer to residents of a foreign jurisdiction (for instance, under most provincial securities laws in Canada a takeover offer for an Australian company made to even one Canadian resident will be regulated by that provincial takeovers law (for example) Quebec, British Columbia, Ontario, Alberta);
- the relevant M&A activity involves the offer or sale of securities to residents or citizens of a foreign jurisdiction (for instance, a prospectus with respect to securities offered to US citizens has not been registered in accordance with s 6 of the United States *Securities Act* 1933).

With the potential for concurrent regulation of a single transaction by Australian and foreign law comes the possibility (or even

7 Although Ch 6 of the *Corporations Act* also regulates the acquisition of control of Australian incorporated unlisted companies with more than 50 members (see s 606(1)(a)(ii)), such a scenario is of less relevance in a cross border M&A context and has not been dealt with in this paper.

probability) of conflict between the different regimes. Whilst conflicting regulatory regimes are not necessarily insurmountable obstacles, such issues certainly have legal and logistical implications for successful merger planning. If the relevant conflict does not fall within the terms of an existing exemption, the only solution is to seek modifications or exemptions from relevant securities regulators: a process which may have significant timing and strategic implications, particularly in the case of an "unsolicited" acquisition.

CROSS BORDER M&A REGULATION

Takeovers

Limited Australian regulation of "foreign" takeovers

As mentioned above, Ch 6 of the *Corporations Act* 2001 (Cth) prohibits the acquisition of a relevant interest in an Australian listed entity which results in voting power for that or another person above 20 percent and below 90 percent unless the method of acquisition falls within a permitted exception. Because Ch 6 only regulates the acquisition of control in targets which are Australian, the potential for Australian law to regulate otherwise "foreign" takeover activity is limited.

The fact that a foreign bidder or target has an existing listing on the Australian Stock Exchange (ASX) will have minimal regulatory impact on a foreign takeover offer. Although there are particular Listing Rules which impose additional limited procedural obligations on a bidder (LR 3.2, 3.3 and 3.10), if the foreign bidder is admitted as a "foreign exempt" entity it will not be obliged to comply with these rules. The issue may have more relevance now that ASX has tightened its admission criteria for foreign entities[8] and more foreign entities listed on ASX are being admitted as "full" listings subject to limited exemptions.

The *Corporations Act* also contains a limited exception for an acquisition of control of an Australian listed entity which occurs as a result of an "upstream" acquisition of another entity, whether on ASX or on another prescribed foreign exchange: see s 611, item 14 of the *Corporations Act*. Therefore cross border M&A activity on a prescribed foreign exchange[9] which has only consequential impact upon the control of an Australian listed entity will not be regulated by Australian takeovers law.[10]

[8] To be admitted as a foreign exempt entity the entity must now have at least A$200 million operating profit before tax for each of the last three years or have net tangible assets of at least A$2,000 million.

[9] See Class Order 02/259 for a complete list of prescribed foreign exchanges. There are currently 14 foreign markets prescribed for this purpose, including the New York Stock Exchange, Toronto Stock Exchange and London Stock Exchange.

[10] Although if scrip is offered the Australian fundraising requirements may regulate the offer: see also s 4.

Foreign regulation of takeovers also regulated by Australian law

As mentioned above, the situations in which foreign law will regulate a takeover which is also regulated by Australian law will depend upon the circumstances of the target and acquirer and the relevant foreign law involved. Because a comprehensive analysis of comparative securities law is beyond the scope of the paper, the issue of regulatory conflict between Australian and foreign law arising from cross border M&A is best appreciated through a case study. Section 3.2 contains an analysis of the cross border legal issues arising with respect to the well publicised battle for Normandy Resources Limited by two foreign bidders, being AngloGold and Newmont.

The Approach of the Securities and Exchange Commission (SEC) and ASIC

SEC

In recognition that the wide scope of the United States securities laws had a deleterious effect on the ability of United States investors to participate in cross border M&As,[11] the SEC adopted new exemptive rules in October 1999 to encourage issuers and bidders to extend tender and exchange offers, rights offerings and business combinations to the United States security holders of foreign private issuers without the need to comply with the disclosure, filing, dissemination, minimum offering period, withdrawal rights and prorogation requirements of the United States Exchange Act and Securities Act registration requirements for securities offers.

The SEC exemptive rules in relation to tender and exchange offers provide that securities of foreign private issues registered under the 1934 Act are exempt from most of the United States takeover rules if United States security holders hold 10 percent or less of the securities proposed to be acquired ("Tier 1" exemption). In judging whether United States security holders hold 10 percent or less, a bidder who does not have an agreement with the target in relation to its bid is entitled to presume that the level of United States ownership is 10 percent or less unless the target has publicly announced otherwise, or the bidder knows otherwise.[12] Rule 802 promulgated under the 1933 Act provides that offers and sales in any exchange offer for a class of

[11] See SEC Release No 33-7759, "Final Rule: Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings".

[12] The aggregate trading volume of the subject class of securities on all national securities exchanges in the United States must also be less than 10% of the overall trading volume within the last 12 months. See r 14d-1 under Exchange Act 1934.

securities of a foreign private issuer are exempt from registration under the 1933 Act if certain conditions are met, including that United States security holders must hold 10 percent or less of the subject securities.

A "Tier II" exemption provides that tender and exchange offers for the securities for foreign private issuers registered under the 1934 Act will be exempt from certain United States tender offer rules[13] that often conflict with foreign regulatory requirements if United States security holders hold 40 percent or less of the subject securities.

ASIC

ASIC has not released a formal policy on conflicting cross border regulation of takeovers, presumably because it takes the view that the ambit of Australian law is sufficiently narrow that in the event of concurrent regulation the desirability of granting an exemption in any respect from Australian law will need to be assessed on its merits. However, ASIC has indicated that:

- in cases where the majority of shareholders are in the United States, it is prepared to grant modifications to the *Corporations Act* to allow automatic extensions and withdrawal rights consistent with the *Exchange Act* 1934;
- in cases where the number of foreign shareholders is small it is prepared to give case by case relief to facilitate the making of a separate bid which complies with the law of another jurisdiction. However ASIC has noted that seeking relief to make separate bids in several jurisdictions greatly increases compliance costs for "minor benefits" to shareholders.

ASIC has indicated that it is prepared to accept "minor differences in procedural rights" in exercising its modification powers, but is not prepared to accept "gross differences or situations where Australian shareholders are offered terms materially worse than those offered to significant numbers of shareholders overseas".[14]

Concurrent Takeovers Regulation: Normandy Case Study

AngloGold Limited (AngloGold), a company incorporated in South Africa and listed on six exchanges including the ASX, London Stock Exchange, Johannesburg Stock Exchange and New York Stock

[13] Under the terms of the exemption, separate offers may be made to US and foreign holders (provided that the terms for US holders are at least as favourable), notice of extensions and payment may be given in accordance with the laws of the home jurisdiction, and the bidder is relieved from the requirement to offer withdrawal rights after the close of the offer period and prior to the commencement of the subsequent offering period.

[14] See ASIC Information Release, 5 February 1999.

Exchange, announced its intention to make a takeover offer for all of the shares in Normandy Mining Limited (Normandy), a company incorporated in Australia and listed on the ASX and TSX (Toronto Stock Exchange), on 5 September 2001. AngloGold lodged its Australian and United States bidder's statement on 17 October 2001 and its replacement Australian bidder's statement on 2 November 2001.

On 14 November 2001 Newmont Mining Corporation (Newmont), a company incorporated in Delaware, United States and listed on the New York Stock Exchange, announced its intention to make a recommended offer for Normandy Mining. Newmont lodged its bidder's statement on 20 December 2001.

AngloGold's initial offer was scrip only, but was later increased to include a cash component. Newmont's offer was scrip and cash.

Australian relief sought

Both bidders were subject to the United States prospectus registration requirements under the 1933 Act with respect to shares issued under the offer to persons located in the United States, and the United States tender offer rules applicable to equity securities not registered under s 12 of the Williams Act.[15] Newmont was not entitled to the benefit of the Tier I or Tier II exemption from the United States tender and exchange offer rules because it was not a "foreign private issuer". AngloGold was not entitled to the benefit of Tier I exemption because Normandy had over 10 percent United States ownership.[16]

Both bidders requested and were granted modifications to the *Corporations Act* to harmonise with the procedure necessary to file a registration statement under the 1933 Act, including:

- allowing holders in United States and Canada to be offered consideration in a different form (shares rather than CHESS Depositary Interests – CDIs) to other holders;
- allowing the bid to be conditional upon receipt by the bidder of shareholder approval;
- allowing for dispatch of a registration statement to holders in United States and Canada at a different time than for other holders;
- allowing for a minimum offer period of one month from the last date of dispatch of offer documents to United States and Canadian holders.

15 See Reg 14E promulgated under the Williams Act.

16 Substantial holders of Normandy Mining Limited at 30 June 2001 were Franco-Nevada Mining Corporation with 19.99%, Maple Brown Abbott Limited with 7.10% and The Capital Group Companies Inc with 6.22%.

AngloGold also received modifications of the *Corporations Act* to allow it to offer additional benefits (low brokerage sale facility available only to Australian shareholders, and an additional subscription facility available to shareholders outside the United States or any other jurisdiction where such offer would not be lawful).

Both takeover bids remained subject to Australian law with respect to withdrawal rights and extensions of the offer.[17]

Cross Border Disclosure Standards

Whilst "all material information" is a common disclosure standard across many jurisdictions for equity fundraising or a takeover, the national practice of a particular jurisdiction can heavily influence the expectation of what is material.

Forecasts

The issue of whether a financial forecast is required to be disclosed is a good illustration of this principle, especially for foreign bidders offering scrip in the Australian market. Foreign bidders listed on the ASX will not be able to take advantage of the "transaction specific" disclosure requirements in s 713 if they are admitted as exempt foreign entities,[18] and will be required to give disclosure to the fuller standard set out in s 710.

In the battle for Normandy, both AngloGold and Newmont took (unsurprisingly) similar views of whether it would be reasonable to include a financial forecast.

In AngloGold's view:

> "the inclusion of forecast financial information would be unduly speculative and potentially misleading for Normandy shareholders. This is particularly so due to the effect that variations in the price of gold and exchange rates may have on AngloGold's future earnings performance. In making this determination, the board has taken into account the facts that AngloGold shares have been listed on securities exchanges around the world for some time and that international practice is not to give forecasts of financial performance where there is

[17] If Normandy's shares had been registered under s 12 of the Williams Act, US law would have required that holders who accept a takeover bid have a withdrawal right at any time while the offer is open, with a minimum offer period of at least 20 business days.

[18] Section 713 is only available with respect to a body which has "continuously quoted securities". Continuously quoted securities must, amongst other things, have belonged to a class of securities that were quoted ED securities at all times in the 12 months before the date of the prospectus. Regulation 1.2A.01 provides that the securities of a body that, under the listing rules of the Australian Stock Exchange Limited, is an exempt foreign entity are not ED securities.

> uncertainty of outcome. In addition, AngloGold has not had access to Normandy's internal financial projections and therefore is not in a position to provide financial forecasts incorporating an acquisition of Normandy."[19]

Newmont's approach was nearly identical:

> "Newmont believes that the inclusion of financial forecasts would be unduly speculative and potentially misleading for Normandy shareholders, particularly due to the effect that variations in the price of gold and exchange rates may have on future earnings performance… In making this determination, Newmont has taken into account the fact that Newmont, Normandy and Franco-Nevada shares are listed on various, internationally recognised securities exchanges and that international practice generally is not to give forecasts of financial performance where there is uncertainty of outcome."[20]

There must be a question as to whether "international practice" is relevant to whether Australian disclosure standards have been met. In ASIC's draft policy statement on prospective financial information, ASIC states that

> "a disclosure document… should not include prospective financial information that does not have reasonable grounds even if it has been used to estimate future performance for internal planning purposes. Prospective financial information without reasonable grounds is not material to investors, nor would an investor reasonably require it or reasonably expect to find it in a disclosure document. The disclosure obligations in the Act do not mandate or allow disclosure of information that is misleading".[21]

Perhaps in most cases there will be little difference between the international practice that a forecast should not be provided where there is "uncertainty of outcome" and ASIC's view that prospective financial information should not be given when it is not based upon "reasonable grounds".

CROSS BORDER REGULATION OF SCHEMES

Where a scheme of arrangement (whether under Australian law or under the laws of a foreign jurisdiction) involves a cross border offer of securities, conflicting regulatory regimes are likely to apply.

19 See s 3.14, AngloGold Bidder's Statement.
20 See s 6.2, Delta Acquisition LLC Bidder's Statement.
21 See [170.5], ASIC draft Policy Statement 170.

For many years, the Australian legal position was unclear with respect to whether a scheme of arrangement (domestic or foreign) involved an offer of securities requiring a prospectus. Most issuers took comfort from ASIC Practice Note 40 which stated that in ASIC's view:

> "No 'offer' or 'invitation' ultimately leading to individual contractual relations is made to the [participants in a scheme of arrangement]. Instead, the… holders are invited to consider proposals which would bind them all. In a reconstruction, a person could be issued securities even if he or she voted against it, unlike an individual contract for purchase of, or subscription for, securities… a distinction must be made between an invitation to cast a vote in a meeting and an 'offer' or 'invitation' to purchase or subscribe for securities (see *Re Wallace Dairy Co* (1980) 5 ACLR 139 and *Re The Bank of Adelaide* (1979) 4 ACLR 393)."[22]

ASIC concluded that the prospectus provisions did not apply, although it stressed that general law concerning fiduciary duties of directors and the prohibition against misleading and deceptive conduct with respect to securities did apply to conduct related to the implementation of a scheme of arrangement.

The position has now been made explicit, as s 708(17) provides that it is not necessary to prepare a prospectus in respect of an offer of securities under a scheme of arrangement conducted under Pt 5.1 of the *Corporations Act*. ASIC has also published a class order (00/185) providing limited relief from the requirement to prepare a prospectus for a foreign corporation listed on an approved foreign exchange offering its securities in connection with a foreign takeover scheme or foreign scheme of arrangement. The fact that ASIC has issued limited class order relief for foreign corporations offering securities in connection with the foreign equivalent of a scheme of arrangement casts doubt on the "no offer" analysis which previously led issuers to conclude that no prospectus was required for a scheme of arrangement.

CROSS BORDER REGULATION OF DLCS

A DLC is (by its very nature) subject to concurrent regulation, as each legal entity remains subject to the law of its home jurisdiction. Although the guiding principle behind the DLC structure is to achieve parity between the two groups of shareholders, on the whole regulators have

[22] Paragraphs [40.11]-[40.12], ASIC Practice Note 40.

remained cautious and reluctant to exempt the resident DLC from the laws of its domicile in order to harmonise the inevitable disparities between regulatory regimes.

ASIC's long-term policy on regulatory relief associated with DLCs has not been published, although in practice it has been willing to grant limited relief from the "association" and "voting power" provisions of Ch 6 of the *Corporations Act* to deal with technical breaches of the law which may occur as a result of the special voting arrangements which are necessary to keep parity between both branches of the DLC. However, in May 2001 ASIC sounded a cautionary note that although

> "the dual listed company structure is a sensible response to Australia's continuing and increased participation in international corporate markets… every significant corporate merger raises unique circumstances which must be carefully considered from a regulatory perspective. The recent prominence of DLC proposals will necessitate the issuing of some general principles by ASIC, but no assumptions about longer term regulatory policy should be made".[23]

ASIC has already indicated that it will not give relief from the requirements for entities reporting under Ch 2M of the *Corporations Act* to:

(a) prepare, lodge, distribute and present consolidated financial statements and single entity financial statements for any Australian entity;
(b) prepare the financial statements in Australian dollars, although ASIC may consider relief to include information in other currencies in additional columns;
(c) prepare financial statements in accordance with Australian accounting standards and other financial reporting requirements of the *Corporations Act* 2001. ASIC expects combined financial statements to be prepared in accordance with Australian accounting standards and the other usual financial reporting requirements of the *Corporations Act* 2001.[24]

CROSS BORDER CONCEPTS IN AUSTRALIAN M&A

Break Fees

There has been much speculation over the last few years as to the legal issues surrounding "break fees": that is, a fee payable by a party to a transaction to another party if the transaction does not proceed.

[23] ASIC Media Release 01/145.
[24] ASIC Practice Note 71[71.15].

Historically in Australia break fees have been resisted by lawyers acting for a target on a number of bases including:

- that the directors of the target may breach their director's duties by approving the entry into such an arrangement;
- that a break fee could constitute a "collateral benefit" if offered to a bidder who is also a shareholder;
- that a break fee is contrary to the Eggleston principles as it deters a competitive market for the target's securities.

The negotiated solution was often to agree break fees, but with a "fiduciary duty carve out" such that the break fee would not be payable in the event that to do so would be a breach of duty by the directors of the target, and provision for a reduction in the break fee to take account of any profit made by the original bidder in the event that a rival bidder was successful.

However in recent times the legal arguments raised by Australian targets to support heavily circumscribed obligations to pay break fees have been met with increased resistance from acquirers, heavily influenced by United States and United Kingdom market practice.

The Takeovers Panel recently has provided guidance on this issue in its decisions in *Re Normandy Mining Ltd (No 3)* (January 2002) and in *Re Ausdoc Group Ltd* (August 2002).

The decision in *Normandy Mining Ltd (No 3)* is of limited use, due to unusual facts surrounding the rival bids for Normandy. The panel did not accept that the market for control of Normandy had been adversely affected by the break fee agreed between Normandy and Newmont because AngloGold was prepared to increase its offer for Normandy after the break fee had been disclosed[25] (both bidders actually increased their offer twice during the course of the bid). The break fee in question was also rendered less objectionable by a supplementary agreement between Normandy and Newmont which provided Normandy and its directors with a number of protections in the event that the panel or a court found the Normandy break fee illegal or made any order against payment of the Normandy Break Fee. In addition, Newmont undertook not to seek payment of the Normandy Break Fee while any challenge was before the panel.[26]

In *Re Ausdoc Group Ltd*, the panel indicated that it found objectionable a break fee payable by Ausdoc Group to ABN AMRO in the event (amongst other things) that ABN AMRO's defeating condition requiring 90 percent acceptances was not satisfied or

[25] Paragraph [13] *Re Normandy Mining Ltd (No 3)*.
[26] Paragraph [38] *Re Normandy Mining Ltd (No 3)*.

waived, and may have made a declaration of unacceptable circumstances had ABN AMRO not undertaken to waive its entitlement to the 90 percent break fee. The panel agreed with ASIC's argument that the 90 percent break fee was objectionable as it may have the effect of coercing shareholders into accepting ABN AMRO's bid. The panel considered that any break fee payable in the same circumstances as the 90 percent break fee may have a coercive effect on shareholders unless it was a de minimis amount.

However, in all other respects the panel found the break fee acceptable, even though it was for more than 1 percent of the value of the bid (the panel's benchmark for reasonableness). The panel accepted that the quantum of the break fees was no more than necessary to reimburse ABN AMRO for the actual costs it has reasonably incurred in its takeover bid for Ausdoc.

Other Lock Up Devices

The panel has also finalised its guidance note on lock up devices.[27] In that guidance note, the panel provides a useful list of the factors which it will consider in assessing the effect of a break fee on competition for control of the target 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.[28]

Although the panel's views on break fees and the effect which they have on achieving an efficient, competitive and informed market for control has become clearer, the panel has stressed that a lock up device which complies with its guidance may still breach directors' duties or the general law[29] (for instance, in relation to related party transactions or financial assistance). Although break fees have definitely become more commonplace in the Australian market in recent years, the legal issues associated with them have not been fully ventilated.

[27] Published in December 2001.
[28] Paragraph [19] Lock Up Devices Guidance Note.
[29] Paragraph [45] Lock Up Devices Guidance Note.

In addition to break fees, the panel also considered other "lock up" devices such as "no talk" and "no shop" agreements. Although the panel has not stated that the use of any one of these devices will amount to unacceptable conduct per se, it has sounded a note of caution. Target directors must be convinced of proper commercial and competitive benefits before agreeing to a "no talk" or "no shop" obligation, and "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]

On the issue of fiduciary duty carve outs, the panel has taken the view that such a carve out is "essential" in the context of a "no talk" agreement, but not essential in a "no shop" agreement. Interestingly, the rationale for this distinction is expressed in terms of director's duties: a "no talk" agreement is not consistent with the directors' duty to "remain open to the consideration of such offers",[31] whereas a no-shop agreement is "materially different in that directors do not have a clear duty to seek out or solicit other offers".[32] Given the distinction which the panel has drawn between its views on lock up devices and the obligations of directors at law, the panel's views could also be supported on an alternative basis, namely that a "no talk" restriction without some form of carve out related to the best interests of target shareholders cannot result in an efficient, competitive and informed market for control of the target.

CONCLUSION

The most significant recent developments and trends in cross border mergers and acquisitions have been the willingness of regulators, especially in the United States and Australia to provide relief to bidders to enable cross border takeovers to be conducted notwithstanding conflicting legislative requirements of the different legislative regimes. This has had a positive impact on the number of cross border takeovers, particularly in the resources sector and more particularly those offering scrip in off shore companies where commonly the legislative differences had caused structuring difficulties.

In addition, globalisation of M&A practices has seen the acceptance by market participants and regulators alike of concepts in Australian M&A transactions such as break fees and other lock up devices which

30 Paragraphs [28]-[29] Lock Up Devices Guidance Note.
31 Paragraphs [31] Lock Up Devices Guidance Note.
32 Paragraphs [31] Lock Up Devices Guidance Note.

have been adopted in numerous recent transactions. The takeovers Panel has released a guidance note endorsing these practices but providing certain suggested benchmarks and cautioning that these types of arrangements should not have the affect of dampening the competitive market for a target company's securities.

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