



ASIC

Australian Securities & Investments Commission

REPORT 270

Response to submissions on CP 159 Acquisitions approved by members: Update to RG 74

December 2011

About this report

This report highlights the issues that arose out of submissions received on Consultation Paper 159 *Acquisitions approved by members: Update to RG 74* (CP 159) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Contents

A	Consultation process	4
B	Our proposed update of RG 74	5
	Relief for trust schemes	5
	Disclosure required for item 7 transactions	6
	Entitlement to vote	8
	Convertible securities	8
	Item 7 placements combined with other control transactions.....	9

A Consultation process

- 1 In Consultation Paper 159 *Acquisitions approved by members: Update to RG 74* (CP 159), we sought feedback on our proposed update of Regulatory Guide 74 *Acquisitions agreed to by shareholders* (RG 74). RG 74 gives guidance on the takeovers exception for acquisitions approved by members—now in item 7 of s611 (item 7) of the *Corporations Act 2001* (Corporations Act).
- 2 The principles underlying the takeovers exception for acquisitions approved by members had not significantly changed but RG 74 required updating because there had been a number of technical legislative amendments since it was last published in 1994.
- 3 There had also been some related policy developments that affected our guidance in RG 74, including the use of item 7 resolutions to implement takeovers of managed investment schemes and the development of policy on expert reports in Regulatory Guide 111 *Content of expert reports* (RG 111). Our proposed update of RG 74, attached to CP 159 as draft RG 74 (with the new title, '*Acquisitions approved by members*'), addressed these issues.
- 4 In response to CP 159, we received two non-confidential submissions: one from the Corporations Committee of the Business Law Section of the Law Council of Australia and the other from Mr George Durbridge. As anticipated, the proposed guidance was not controversial because it reflected well-established policy that we have applied in practice for some time.
- 5 The key policy or technical issues raised in the submissions, and our response to these, are explained in this report. This report is not a summary of all the issues raised in the submissions, which are available for review on our website at www.asic.gov.au/cp under CP 159.
- 6 We have re-issued RG 74, incorporating the updates contained in the draft guide attached to CP 159, as modified through the consultation process.
- 7 Since CP 159 was published, we have seen some item 7 transactions that were combined with takeover bids or other control transactions. In RG 74, following some informal consultation, we have included guidance setting out our concerns with some of these transactions and asking parties proposing such transactions to contact us early in the planning stage. We will continue to monitor these transactions and develop policy as necessary.

B Our proposed update of RG 74

Key points

The main comments that we received in response to CP 159 related to:

- class order relief for trust schemes;
- the disclosure required for item 7 transactions; and
- the voting requirements.

We do not consider that class order relief for trust schemes is appropriate. We have clarified our guidance on disclosure and voting requirements.

Relief for trust schemes

- 8 Our proposed update of RG 74 explained the relief we give for takeovers of managed investment schemes that rely on item 7. These ‘trust schemes’ require relief from the voting restriction in item 7(a)(ii) because the offer is made to all members.
- 9 Draft RG 74 explained that, before giving relief for trust schemes, we need to be satisfied that the trust scheme will not undermine the protections and principles of Ch 6. Before giving this relief, we also closely review the draft disclosure.
- 10 One respondent said that the relief for trust schemes is well settled and should now be the subject of class order relief. They commented that ASIC does not need to use an application for relief as a means of ensuring the transaction complies with Ch 6, especially as the documents need to be lodged with ASIC 14 days before dispatch.

ASIC’s response

Trust schemes have a fundamental impact on the control of an entity and members’ rights. For this reason, we need to consider them on a case-by-case basis and class order relief is not appropriate.

The application process enables us to take a proactive role at a relatively early stage in the transaction. In practice, it is common for us to negotiate changes to the draft disclosure before giving relief, and this often takes some time if the transaction is complex.

Disclosure required for item 7 transactions

Guidance on ‘material information’

- 11 Formerly, the disclosure requirements for takeovers approved by members arose under the common law and Eggleston principles rather than the statutory provision itself. This is because the predecessor provision (s623) was silent on the disclosure required. Item 7(b) of s611 now provides that members should be given all information known to the acquirer, its associates or the target entity that is material to the decision on how to vote on the resolution.
- 12 In our view, these legislative amendments supplement the disclosure that should be provided to members. Information is therefore now required under item 7(b), the Eggleston principles and the common law.
- 13 Our draft update of RG 74 retained guidance on the ‘material information’ that will generally be required—including:
- (a) the reasons for the transaction, material terms and any other relevant agreements between the parties;
 - (b) information on the acquirer’s intentions regarding the future of the target entity;
 - (c) the interests that any director has in the transaction;
 - (d) details about any persons who will become a director if members approve the transaction;
 - (e) the recommendation of each director; and
 - (f) an analysis of the proposed acquisition that complies with the requirements in RG 111.
- 14 One respondent commented that our guide should make it clear that the test for information is set out in item 7(b) and that the guidance is ASIC’s view of what would usually be required. They said that RG 74 should not impose requirements beyond the Corporations Act. They also commented that there may be certain technical item 7 transactions where only minimal disclosure would be required.

Expert reports

- 15 Draft RG 74 stated that we consider the directors of the target entity should give members an independent expert report or a detailed directors’ report on the proposed transaction. This was very similar to our original guidance in RG 74, which also contained extensive guidance on the type of analysis required. We merely replaced the guidance on the analysis required with a reference to RG 111, which now has guidance on the content of reports on item 7 transactions.
- 16 Both respondents commented that an independent expert report or detailed directors’ report would not always be required for an item 7 transaction.

- 17 Draft RG 74 also stated that we closely examine any report prepared by directors because, in our experience, there is a significant risk they will not provide all material information to members. We did not receive any comments on this guidance.

Acquirer's intentions

- 18 Draft RG 74 stated that disclosure of 'material information' should include information on the acquirer's intentions regarding the future of the target entity. This is analogous to the disclosure required in a bidder's statement under s636(1)(c). One respondent said that the acquirer should not defer formulating intentions until after the transaction is approved in order to avoid disclosure.

ASIC's response

We consider that RG 74's well-established guidance on the disclosure of material information remains valid. The guidance does not seek to impose additional mandatory requirements but comments on information that we consider will generally be required under item 7(b)'s material information test and the common law. This is consistent with our approach to other general disclosure tests—for example, our guidance on the general disclosure test in s710 is set out in Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228).

We agree that an independent expert report or detailed directors' report is not always required, but we consider this will be in very limited circumstances. We note that standard market practice is to provide members with an independent expert report.

We agree that an acquirer should give candid disclosure on its intentions for the future of the target entity, especially if the acquirer may gain control of the entity after the item 7 transaction is approved. We have added guidance to that effect.

Guidance on voting power

- 19 Item 7(b) now specifies that members should be given certain information on the voting power of the acquirer and its associates, including the maximum increase in voting power. Draft RG 74 provided guidance on these requirements.
- 20 One respondent agreed with the guidance on disclosure of voting power but suggested that the resolution itself should state the maximum voting power. The other respondent said that shareholders' attention should also be focused on the maximum effect because that is what they are being asked to approve.

ASIC's response

We agree with these comments and have added that the resolution itself should specify the maximum voting power that may result from the acquisition.

Entitlement to vote

- 21 Item 7(a) restricts the acquirer, the vendor and their associates from casting votes in favour of the resolution. Draft RG 74 gave some guidance on these voting restrictions. It also explained when we may give relief to enable ‘excluded’ nominees or trustees to vote in favour of an item 7 resolution if they hold shares for non-excluded persons.
- 22 One respondent said that the relief for trustees and nominees should be by class order.

ASIC’s response

We give relief to permit nominees to vote for non-excluded members quite often in the context of trust schemes (where it is given with the other extensive case-by-case relief required for these transactions). However, relief for nominees is rarely requested on its own and, at this time, class order relief does not appear necessary.

Convertible securities

- 23 RG 74 originally stated that acquisitions that occur in the distant future involving the exercise or conversion of options or notes may be rejected by the court as being too uncertain for shareholders to be able to approve. It also pointed out that the approval may be invalidated if the person acquired more shares between the time of shareholders giving their approval and the time of exercise of the notes. Similarly, a capital reduction may end up causing the holder to obtain a higher voting power than originally approved
- 24 Draft RG 74 contained similar guidance on these issues of ‘changes in circumstances’ and ‘time between member approval and item 7 acquisition’. The guidance was not restricted to convertible securities because we consider that similar issues can arise with other types of item 7 acquisitions, although most commonly they arise with convertible securities.
- (a) We said that an item 7 acquisition that will only be completed in the distant future may deter other takeover bids and undermine the efficient market for control of the target entity. We also said that it may be difficult for directors to satisfy their obligation to give full disclosure.
- (b) We said that fresh approval should be obtained if the acquirer would end up with a higher voting power than originally approved (due to further share acquisitions or a consolidation of the company’s share capital). This is more of a risk if the item 7 acquisition completes in the distant future.

- 25 The comments that we received suggested that draft RG 74 did not give clear guidance on how these issues apply to convertible securities. This may be partly because we said that ‘it is preferable that an item 7 acquisition is completed as soon as practicable after member approval is obtained’, which may have implied that convertible securities should be exercised within a short period.

ASIC’s response

Our draft guidance on changes in circumstances and distant completion was based on guidance that had originally been given in relation to convertible securities. We consider that these issues have a broader context but that our guidance still applies to convertible securities.

We have removed the reference to item 7 acquisitions being ‘completed as soon as practicable’ because this may give the impression that convertible securities should be exercised within a short period of time. Also, our concerns are mainly focused on acquisitions that occur ‘in the distant future’.

Item 7 placements combined with other control transactions

- 26 One respondent raised the issue of s609(7) being used to prevent a relevant interest arising if the parties have no intention of having the acquisition approved under item 7. The respondent commented that this can be unacceptable if s609(7) is used to shelter a pre-bid option. Other stakeholders have separately raised the issue with us and also expressed concern over the use of s609(7) to effectively lock up a large parcel of securities before a takeover or scheme of arrangement.
- 27 Since CP 159 was released, we have also seen some transactions where an item 7 placement has been inter-conditional with another control transaction that will allow shareholders to exit if the transactions proceed (e.g. a bid or share buyback).

ASIC’s response

RG 74 encourages parties to consult with us early about item 7 placements that are inter-conditional with takeover bids or other control transactions because, in some circumstances, the structure may be contrary to the principles in s602 and the purpose of the voting exclusion in item 7.

We agree that it is also contrary to Ch 6’s principles to use s609(7) if there is no intention to seek shareholder approval under item 7. We have added guidance on this issue and a reference to the Takeover Panel’s decision in *oOh!media Group Limited* [2011] ATP 9.