



ASIC

Australian Securities & Investments Commission

REPORT 286

Response to submissions on CP 170 Downstream acquisitions: Update to RG 71

May 2012

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 170 *Downstream acquisitions: Update to RG 71* (CP 170) and details our responses in relation 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.

This report does not contain ASIC policy. Please see Regulatory Guide 71 *Downstream acquisitions* (RG 71).

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A Overview/Consultation process

- 1 In Consultation Paper 170 *Downstream acquisitions: Update to RG 71* (CP 170), we consulted on proposals to update and revise our guidance in Regulatory Guide 71 *Downstream acquisitions* (RG 71). RG 71 gives guidance on when ASIC will grant relief to permit a downstream acquisition that does not satisfy the exemption in item 14 of s611 (item 14) of the *Corporations Act 2001* (Corporations Act).
- 2 RG 71 required updating because it was last updated in 1996 and was drafted in line with the predecessor provision to item 14, which was more limited than the current exemption in item 14. However, the principles relevant to when ASIC will grant relief to permit a downstream acquisition that does not satisfy the exemption in item 14 have not significantly changed.
- 3 This report highlights the key issues that arose out of the submissions received on CP 170 and our responses to those issues.
- 4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 170. We have limited this report to the key issues.
- 5 For a list of the non-confidential respondents to CP 170, see the appendix. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 170.
- 6 We have reissued RG 71, incorporating the proposed updates contained in the draft regulatory guide attached to CP 170 (draft RG 71), as modified through the consultation process.

Responses to consultation

- 7 We received five submissions in response to CP 170 from members of the legal and independent expert communities. We are grateful to respondents for taking the time to send us their comments.

B Our proposed update to RG 71

Key points

The main comments that we received in response to our proposals in CP 170 related to:

- our approach to the exemption in item 14;
- our relief for downstream acquisitions;
- the factors relevant to our decision on whether or not to grant relief; and
- the conditions of our relief.

Approach to the exemption in item 14

- 8 Our proposed update to RG 71 (draft RG 71) set out our approach to the exemption in item 14. The submissions received were broadly supportive of our approach to the exemption in item 14 and when we may apply to the Takeovers Panel for a declaration of unacceptable circumstances despite the exemption in item 14 applying.
- 9 One respondent said that we should only intervene in circumstances where the downstream acquisition is not merely incidental to the upstream acquisition, or where the upstream acquisition is an artifice with the main objective being to acquire control of the downstream company. The respondent also said that we should apply the same approach to granting relief as to deciding whether or not to apply to the Takeovers Panel in relation to a downstream acquisition.
- 10 Another respondent said that RG 71 should acknowledge that exemptions in s611 other than item 14 may apply to downstream acquisitions.

ASIC's response

Whether the circumstances of a downstream acquisition are unacceptable will depend on the particulars of each case.

We consider that the factors relevant to our decision on whether to grant relief for a transaction that would otherwise be unlawful are not necessarily the same when deciding whether circumstances in relation to a downstream acquisition may be unacceptable. We note that this distinction was acknowledged by the Takeovers Panel in *Leighton Holdings Limited 02 R [2010] ATP 14* at paragraphs 54–55.

The reissued RG 71 acknowledges that there are different views on whether other exemptions in s611 may apply to exempt a

downstream acquisition from the prohibition in s606 where item 14 is not satisfied.

We have retained our guidance in RG 71 that, in cases where an acquirer is relying on an exemption in s611 other than item 14, the downstream acquisition may risk regulatory action by us, including an application to the Takeovers Panel.

Relief for downstream acquisitions

- 11 Our proposed update to RG 71 explained the factors that we would consider when deciding whether to grant relief to allow a downstream acquisition that does not satisfy the exemption for downstream acquisitions in item 14.
- 12 Draft RG 71 explained that, before giving relief, we must be satisfied that relief would be consistent with the policy behind the exemption in item 14 and the principles in s602. We must also be satisfied that the regulatory detriment is minimal or clearly outweighed by the resulting commercial benefit of granting relief, that the upstream acquisition is legal in the jurisdiction where it takes place, and that it does not appear to us that the downstream acquisition would give rise to unacceptable circumstances.

Approach to relief applications

- 13 Draft RG 71 provided guidance on our approach to applications for relief for downstream acquisitions, and set out the circumstances where we would not grant relief to facilitate a transaction that is not exempt under item 14. The submissions received were broadly supportive of our approach.
- 14 One respondent said that the focus of our approach to granting relief should be based on whether the transaction is merely incidental to the upstream acquisition or whether the upstream acquisition is a clear artifice to acquire control of the downstream company.
- 15 One respondent said that we should only refuse to grant relief where an applicant is unwilling to accept appropriate conditions proposed by us.

ASIC's response

We believe that the guidance provided on our approach to relief applications, and the factors we will consider, are appropriate to cover the variety of matters that will be relevant in these complex transactions.

We consider that the circumstances set out in our guidance about when we will not grant relief to facilitate a downstream acquisition that would otherwise be unlawful are appropriate and consistent with the policy behind the exemption in item 14.

Class order relief

- 16 Draft RG 71 stated that we may grant relief to permit downstream acquisitions not exempt under item 14 on a case-by-case basis.
- 17 Two respondents said that we should provide a single ‘safe harbour’ by way of class order relief for downstream acquisitions that are not exempt under item 14. One commented that class order relief should be available on the basis of the value of the interest held by the upstream entity in the downstream company being less than 33% of the enterprise value of the upstream entity. Another said that class order relief should be given for all downstream acquisitions on condition that the acquirer (at its own election) make a downstream bid or sell down the interest in the downstream company to below 20%.

ASIC’s response

Transactions involving downstream acquisitions occur infrequently and are generally complex. Downstream acquisitions may have a fundamental impact on the control of the downstream company.

We consider it is important for us to take into account the purpose and effect of the upstream acquisition on the control of the downstream company on a case-by-case basis. The application process also allows us to tailor appropriate conditions of relief to the particular circumstances of each case.

The re-issued RG 71 states that we will continue to monitor downstream acquisition transactions and consider new developments in this area, as appropriate.

Approved foreign exchanges

- 18 The purpose of draft RG 71 was to propose updates and revisions to our policy. The purpose was not to revisit the list of approved foreign exchanges contained in ASIC Class Order [CO 02/259] *Downstream acquisitions: foreign stock markets* for the purposes of item 14.
- 19 One respondent said that there was some support for re-examining the approval of internationally recognised exchanges in [CO 02/259] and, after consultation, we should consider restricting the availability of the complete exemption in item 14 to foreign exchanges where the regulatory regime does not effectively replicate the Australian domestic position.

ASIC’s response

We consider that [CO 02/259] is consistent with the policy behind the exemption in item 14, which includes the aim of enhancing international comity through the removal of obstacles to primarily foreign business transactions. The list of approved foreign exchanges in [CO 02/259] achieves this policy objective.

At this stage, ASIC does not intend to revisit the list of approved foreign exchanges in [CO 02/259]. However, we will consider applications to approve foreign exchanges not included in the list in [CO 02/259] on a case-by-case basis.

Unconditional relief

- 20 Draft RG 71 stated that we may grant relief without conditions in rare and exceptional circumstances.
- 21 One respondent said that we should give unconditional relief where:
- (a) the upstream entity is listed on a sub-exchange of an approved foreign exchange and is subject to the same or similar regulatory requirements as the main board; or
 - (b) the upstream acquisition is unregulated, provided that the acquisition does not result in effective control of the downstream company passing to the acquirer of the upstream entity.

ASIC's response

Generally, the regulation that applies to sub-exchanges is not the same as the regulation that applies to the main board. For this reason, we do not believe that unconditional relief should be automatically available for sub-exchanges where the main board is approved by us. An applicant may apply to ASIC to consider adding the relevant sub-exchange to ASIC's list of approved foreign exchanges included in [CO 02/259].

The policy rationale behind the exemption in item 14 includes preserving the free flow of shares in widely held entities listed on appropriate exchanges. We do not consider that the policy behind the exemption in item 14 supports unconditional relief from the prohibition in s606 where the upstream transaction is unregulated.

Factors relevant to our decision about relief

Control purpose test

- 22 Draft RG 71 explained the factors that would be relevant to our decision on whether or not to grant relief where a downstream acquisition is not exempt under item 14. This included guidance on the key concepts of 'control purpose', 'substantial assets' and 'effective control', and our proposed change to the 'control purpose' test.
- 23 One respondent said that there was an overlap between these three concepts and that ASIC should remove the 'control purpose' test from our policy

because, in practice, the effect on control would be easier to determine than a person's intentions.

- 24 One respondent said that we should not change the 'control purpose' test and that, instead, we should retain the 'main purpose' test—that is, whether control of the downstream company is *not* one of the main purposes of the upstream acquisition.
- 25 Two respondents who did not agree with our proposed change to the 'control purpose' test proposed different formulations of the 'control purpose' test because they said that the test, as set out in draft RG 71, was not sufficiently clear. One of these respondents proposed that we adopt ASX's guidelines on 'main undertakings' in ASX Listing Rules Guidance Note 12 *Significant changes to activities* or the Australian Competition and Consumer Commission's (ACCC) *Merger guidelines*. The other respondent suggested that we adopt a rebuttable presumption test of a control purpose where the downstream company represents more than 33% of the enterprise value of the upstream entity.

ASIC's response

Our guidance distinguishes between 'control purpose', 'substantial assets' and 'effective control' because we consider that it is relevant to look at the purpose of the upstream acquirer as well as the effect of the upstream acquisition on the control of the downstream company.

We have not retained the 'main purpose' test in light of the comments made by the Takeovers Panel in *Leighton Holdings Limited 02 R [2010] ATP 14*.

We understand that parties wish to have certainty about when the 'control purpose' test will be met. However, whether relief will be appropriate will depend on the circumstances of the downstream acquisition. As such, any bright-line test will be arbitrary. Accordingly, we consider that our guidance in draft RG 71 is appropriate because it enables us to adapt the test to the circumstances of the relevant downstream acquisition.

Conditions of relief

- 26 Draft RG 71 explained the factors we would consider when determining the types of conditions that may apply to our relief. The submissions received were broadly supportive of our proposals.
- 27 One respondent said that we should consider applying different types of conditions at different stages of a transaction to accommodate multiple stages in a transaction. Another respondent said that, where relief is not subject to a downstream bid or sell-down condition, we should impose

conditions that an acquirer must make a downstream bid or sell down the downstream shares if it obtains absolute or effective control within 12 months of the initial acquisition.

ASIC's response

We expect that, in practice, we will be able to determine what conditions are appropriate before a transaction proceeds. We are also mindful of the need for applicants to have certainty about the conditions that will apply to our relief before a transaction proceeds.

If a transaction changes, or a person acts in a way that is contrary to the conduct that was contemplated and advised to us at the time relief was granted, we will consider whether the conditions imposed on relief continue to be appropriate and/or whether we have s602 concerns about the transaction.

Independent expert valuations—Downstream bid condition

- 28 Draft RG 71 provided guidance on independent expert valuations that are used to fix the price of a downstream bid (where it is not possible to determine the ‘effective’ price being offered for the downstream shares from the upstream acquisition price). The submissions received were broadly supportive of our guidance on independent expert valuations.
- 29 The majority of respondents agreed with our guidance on the information that should be made available to the independent expert. One respondent said that the independent expert should not be limited to using information made available and used by the acquirer when assessing the fair value of the downstream shares.
- 30 Some respondents thought that, where new circumstances occurred, a revised independent expert’s report should not be required unless the new circumstances caused a readjustment to the purchase price of the upstream entity. The respondents said that, in this case, it would be a matter for the directors of the downstream company to determine whether to revise their recommendation or commission an independent expert to give an opinion on the fair value of the downstream shares in light of the new circumstances.
- 31 Draft RG 71 stated that the downstream bid price would generally be the midpoint of the valuation range, or the highest midpoint where a range of valuation ranges are given. Draft RG 71 also stated that we would consider requests to vary the terms of relief on this point, taking into account the advice of the independent expert.
- 32 The majority of respondents agreed with our guidance on the pricing of the downstream bid where a range or ranges are used by the independent expert in valuing the downstream shares. One respondent disagreed that the midpoint would generally be the appropriate method to set the downstream

bid price. Another respondent said that the low or high end of a valuation range may be appropriate in some cases.

ASIC's response

The reissued RG 71 clarifies that when determining the value per share on the basis of information that was available to the acquirer at the time the acquirer was fixing the price of the upstream acquisition, that the independent expert is not limited to information that was used by the acquirer.

We agree that a revised independent expert report should not be required in relation to new circumstances that do not result in a readjustment of the upstream acquisition price. However, we consider that it may be appropriate for the independent expert to make a statement about the status of the independent expert report. We have updated RG 71 to clarify this position and confirm that, where a revised independent expert report is required, this may be provided by way of a supplementary report.

We acknowledge that every point within an independent expert's assessed valuation range will be 'fair'. However, the purpose of an independent expert's valuation is not to set a bare minimum price for the downstream shares. Generally, we consider that the midpoint is the most appropriate means of setting the downstream bid price.

The reissued RG 71 provides some further guidance on independent expert reports and the effect of new circumstances in relation to the downstream company. Our guidance states that an independent expert's report should prominently disclose that:

- the purpose of the report is to set the downstream bid price and not to provide a 'fair and reasonable' opinion of the downstream bid (unlike an independent expert's report prepared in other control transactions); and
- the report has been prepared on the basis of information available at the time the price of the upstream acquisition was fixed and therefore will not take into account any new circumstances that arise in relation to the downstream company that may affect the fair value of the downstream shares.

The reissued RG 71 states that, where new circumstances arise in relation to the downstream company, directors of the downstream company should consider whether to amend their recommendation, and also what valuation material to put before shareholders to assist them in making a decision about the downstream bid.

Standstill and voting conditions

33 Draft RG 71 stated that, when considering whether to impose standstill and voting conditions on our relief, we would consider all the relevant

circumstances. The submissions received were broadly supportive of our proposals.

- 34 Two respondents said that standstill and voting conditions may be inappropriate where these would materially distort the distribution of voting power in the downstream company (including another shareholder acquiring negative control of the downstream company). One respondent also said that these conditions should be subject to a *prima facie* limit of 26% of the downstream shares.

ASIC's response

The reissued RG 71 states that, before we impose standstill and voting conditions on our relief, we will consider the impact of the conditions on the downstream company, including the impact on the distribution of voting power in the downstream company.

We have not adopted a *prima facie* limit on the relevant percentage of downstream shares subject to the conditions because we consider that appropriate limits will depend on the circumstances of each case. In addition, we are mindful that, where standstill and voting conditions are not practicable, more onerous conditions will apply to our relief (i.e. such as a downstream bid condition).

Sell-down condition

- 35 Draft RG 71 stated that we may consider applying other conditions to our relief, either instead of or in addition to standstill, voting or downstream bid conditions. In particular, we proposed in CP 170 a sell-down condition as an alternative to a downstream bid condition in appropriate cases. The submissions received were broadly supportive of our proposals.
- 36 One respondent said that an acquirer should be able to choose whether a downstream bid condition or a sell-down condition would apply to our relief. The respondent also said that the broker selling the downstream shares should be permitted to sell the shares to anyone (subject to s606) because placing the shares widely may not be in the best interests of the downstream shareholders.

ASIC's response

While the preference of the acquirer will be relevant, we do not consider that a sell-down condition will be appropriate in all cases.

We consider that our guidance on the method of the sell-down is consistent with our policy in Regulatory Guide 31 *Acquisitions by a broker acting as principal for client facilitation purposes* (RG 31). We consider that a wide placement will normally be in the best interests of downstream shareholders.

Appendix: List of non-confidential respondents

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- Corporations Committee of the Business Law Section of the Law Council of Australia
 - Durbridge, Mr George
 - Grant Samuel & Associates Pty Limited
 - KPMG Corporate Finance (Aust) Pty Ltd
 - Minter Ellison Lawyers
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