13 January 2023

To: Corporations team
Australian Securities and Investments Commission
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Submission to Consultation Paper 365

Remaking ASIC class orders on takeovers, compulsory acquisitions and relevant interests

This is a personal, but not private, submission into the consultation process aimed at the remaking of a number of class orders on takeovers, compulsory acquisitions and relevant interests into ASIC instruments.

My submission is educated by my grass roots interactions as a share registry professional, over a fifteen year period, managing and observing the detail of the registry functions for hundreds of takeover bids for bidders and the targets' response. I also bring to the topic many years of experience managing the interaction with takeover bids for clients of a professional custodian and my deep understanding of CHESS, from theory to its implementation and subsequent refinement. Those takeover bids I have been involved with cover takeover bids for ASX listed, multi-market listed and unlisted company shares, trust units and stapled securities. Those takeover bids offered cash and scrip consideration in many combinations and forms.

Some of my submission draws attention to matters outside the published scope of CP365. Most of this submission is aimed at operating takeover bids effectively and efficiently and issues or improvements that I believe should be considered to improve their operation and predictability for target shareholders, shareholders' agents and bidders.

I hope that I get to discuss the content hereabouts with the ASIC team and have the opportunity hear to your feedback.

Proportional takeover bids—small parcels

ASIC Class Order [CO 13/521].

> *"Proportional takeover bids—small parcels*
>
> *(2) If accepting an offer under a proportional takeover bid for quoted securities would leave a person with a parcel of the securities that is a small parcel, the offer extends to that parcel.*
>
> *This subsection (including the application of this subsection to the circumstances specified in subsection (2B)) does not apply to a parcel of securities, whether held beneficially or otherwise, that has come into existence or increased in size because of a transaction entered into (including the creation of one or more trusts) after the bid was publicly proposed."*

The highlighted section above requiring discovery by the bidder of the delta in the target's register between announcement and acceptance of its offer is rarely if ever managed in the manner contemplated because of a lack of required data, or even the right of the bidder to access that data, and overall the definition of small parcels is too technical and obscure for most target shareholders.

Discovery of the changes to parcels

There is often an noticeable period of time between the date a bidder makes its intentions public and the date when a bidder has access to detailed information from the target register[1] (unless the bidder has already secured a complete and an appropriately indexed copy of the target's register on the day of announcement via other search powers). Therefore the bidder and their registry provider has insufficient information to clearly identify 'parcel splitters'.

There is also a legitimate group of investors whose on-market trade or off-market transaction was made formal before the bid was announced, but was recorded in the target's register afterwards:

- each trade on ASX, whether purchase or sale, has a two day lag between trade and broker to broker settlement, so the settlement of a purchase or sale trade executed in close proximity to the bid's announcement might give the appearance of a new parcel or subsequent change to create a smaller parcel;
- if a parcel that would have created a residual worth more than $500 at announcement or despatch of the offer declines in value at acceptance, the result is different for the investor through no fault of their own; and
- all transactions manually handled by the share registry, including issuer sponsored to CHESS transfers managed by a non-broker and transmissions and transfers for a deceased estate, will experience a delay between contract, execution, lodgement and effect in the target's register.

In any event neither the target's share registry or the bidder's registry have any insights into the transactions entered into inside the CHESS subregister. Participants may transact in CHESS via the settlement batch or as bilateral demand transfers between participants. The results of both intra-CHESS transaction types are passed to the target's registry as a net summary of movements on or off the CHESS subregister, and are eventually relayed to the bidder only as static point in time unit balances, never at a transaction level.

This highlighted section above seems like an overreaction to the actions of a small number of opportunistic target shareholders in GoldLink IncomePlus Limited's register during the Emerald Capital Limited's proportional takeover bid in 2009[2]. Having observed both the Emerald Capital bid for GoldLink IncomePlus Limited and many other proportional bids at close quarters over fifteen years the former has been unique in the scale and audacity of the parcel splitting.

Since the GoldLink IncomePlus Limited takeover bid ASX has been more stringent in its enforcement actions against market participants creating unmarketable parcels.

A bidder whose professional registry finds evidence of splitting should be capable of alerting the bidder to its findings and as Emerald Capital did, take the matter to the Takeovers Panel. One-off instances can be dealt with surgically, rather than overcomplicating the whole administration and substantial shareholder reporting for every proportional bid and every acceptance of the offer.

The controls in place to prevent or stifle the consequences of parcel splitting have moved on since 2009. The Takeovers Panel's declaration of unacceptable circumstances and its orders carried in GoldLink IncomePlus Limited 04 has set the scene for the consequences for investors contemplating parcel splitting. I believe there should be a suitable reference to the bidder's intentions about denial of split parcels in the bidder's statement for future proportional takeover offers.

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[1] Corporations Act section 641(1)

[2] *Share splitting- GoldLink IncomePlus Limited 04 [2009] ATP 2, [37]-[40]*
http://takeovers.gov.au/content/DisplayDoc.aspx?doc=reasons_for_decisions/2009/002.htm&pageID=&Year=2009

ASIC also has some means to track attempted abuse of process through the market via its other market surveillance activities, and therefore has the opportunity to detect and deal with the practice directly with market participants that might try to facilitate it. By extension participants that have historically split parcels after a trade settles are captured by ASX Settlement Operating Rules and the supervision and disciplinary oversight of ASX. It is interesting that since 2012 none of the disciplinary notices published on ASX's website cite a broker for creating or splitting parcels as it seems the $15,000 fine levied on Macquarie Equities in 2009 [3] has been sufficient deterrent to others.

Definition of unmarketable parcel / small parcel

There is also insufficient clarity and transparency for accepting shareholders who hold smaller parcels of shares to understand if they will be protected against holding unmarketable parcels after their acceptance of a bid. It is difficult for a small shareholder to determine when their acceptance will be processed and if the remainder will be treated as a small parcel or not.

A small parcel takes it shape from a convoluted reference to an unmarketable parcel in ASX's rules combining a market value and a point in time - the closing price of the securities on that prescribed financial market on a day.

The qualifying criteria and activity that interact to calculate a remaining small parcel are outside both the control and clear understanding of a retail investor. The first is the future market price for their shares and second when their acceptance will be received and subsequently will be processed by the bidder's registry or their broker and/or CHESS. The result is a threshold amount of shares, by number.

This is made even more confusing for the retail investor as ASX quotes two separate markets for the target securities during the full period of a proportional takeover offer; cum offer (i.e. ABC:ASX) and ex offer (i.e. ABC***E***:ASX) and the two prices can be different with very few days, historically, of trade and even bids and offers in the ex-offer ticker.

A bidder should be able to easily and clearly communicate to target shareholders through its Bidder's Statement and accompanying personalised acceptance and transfer form what parcel of shares would have both the proportion under offer and the unmarketable parcel remainder acquired. I propose this is based on the constants of the:

- cash consideration; or
- share price value the bidder used to calculate the premium/discount to its offer, when using scrip consideration.

This approach allowed the bidder's registry to provide much clearer instructions on the personalised transfer and acceptance forms and instructions via ASX bulletins to CHESS participants who managed the process for their sponsored clients.

By taking the approach in the preceding paragraph, the bidder will be better placed, on receipt of the target register, to opine more accurately on the total cash consideration required and its capacity to fund the cash consideration payment including the prospect of acquiring all the remaining small parcels as at the register date. This level of precision will not be possible using the current method for determining small parcels.

If the consideration changes then every target shareholder who remains in the register, including those who have not accepted the offer, must be informed of that consideration change. So the bidder can take that opportunity to communicate any reset of its small parcel calculation and any new threshold number of shares making up a small parcel, and with the target register information in hand, again make a more accurate disclosure about the funding required and its capacity to pay.

[3] https://www.asx.com.au/supervision/pdf/astc_bulletin_566_09_macquarie_equities_ltd.pdf

Under the current state, in the event a proportional takeover bid was made for a security that was on the ASX Official List, but was suspended from trading (Keybridge Capital Limited for example) the current formula, though having to be tested each day, would generate the same result – a specific threshold of shares by number because of the constant of the historical last price traded.

The situation can become much more complicated when the reference price may be sourced from a market (as proposed in paragraph 154) that does not quote prices in $A, so an appropriate foreign exchange benchmark rate must be established to bring back the foreign currency price to $A. The situation is worse if each market has a different definition (or no definition) of a marketable parcel or minimum parcel. Should the defined term of the target's primary market be the deciding definition, so there are fewer variables to deal with?

A fluid input into the calculation of small parcels also subtly complicates the bidder's registry processes for reporting acceptances, a bidder's interests and therefore substantial shareholder reporting and other obligations in Chapter 6 if a key threshold is passed during the offer period.

The law must adopt a more practical solution to the problem of unmarketable parcels that would remain after acceptance and the bidder's rights and obligations for acquiring small, remaining parcels.

Custodian shareholders

Most custodians own shares in its nominee name in an omnibus account. Most professional custodians are direct participants in CHESS, hold all listed securities on the CHESS subregister, and **never** submit acceptance forms for listed securities in support of their acceptance of the bid.

For a custodian holding securities in CHESS, as a direct holder, on behalf separate and distinct owners the disclosure and certification expected of the parties involved in its acceptance of a proportional takeover bid on behalf of its underlying owner fights against the only method at the custodian's disposal to give its acceptance, an electronic acceptance message via CHESS. A CHESS takeover acceptance message already carries a field that clearly advises the bidder that the acceptance is in relation to a distinct parcel, or not. That takeover acceptance is not signed, certified or delivered by post, but is managed in accordance with ASX Settlement Operating Rules.

If the bid was over an unlisted share, the custodian would have to coordinate the distinct owners' disclosure with the surrender of the custodian's share certificate(s) and executed acceptance forms.

Having to make a physical declaration on behalf of their separate owners for every acceptance will significantly add to the financial cost to the custodians, uncertainty about the reporting to a bidder about their relevant interest and create some doubt on the authenticity of the bidder's substantial shareholder disclosures until the 'proof' of a parcel certificate was overlayed on the electronic CHESS takeover acceptance.

Historically, the custodians, nominees and trustees holding distinct parcels in CHESS for underlying clients have not been the source of abuse of parcel splitting.

Performance rights exercised during the bid period – s633(2)

In my experience the registry and some advisers to a bidder are not always conscious of either the need to seek relief to extend s617(2) to performance rights issued by the target and are also their instructions lack precision about what disclosure documents that the performance rights holders should be served.

I am in support of the proposition to amend s617(2) to permit a bidder to extend its offer to bid class securities issued after the date set by the bidder under s633(2). However, the proposition should also be clear what disclosure documents, including acceptance forms, must be sent to the performance rights holder. If the vesting, conversion of, or exercise of rights attached to, performance rights is late in the offer period and after a control event clause is triggered, the new target shareholder should have the means to accept the offer and not have to rely on compulsory acquisition to access the offer consideration, commitments about payment timeframes and any choice of consideration, presuming the bidder acquires the necessary ownership levels to compulsorily acquire.

Entitled to be registered is an ancient concept that should be eliminated

The 'entitled to be registered' protection for a buyer of a listed security during the bid period dates back to when trade on ASX was settled on a demand basis when the stockbroker had accumulated enough paperwork to deliver to the share registry and in an era of manual registration of the buyer.

It was commonplace up until the 1990s for recent buyers to experience significant delays between buying on market and having evidence of ownership received via a share certificate, so some buyer protection processes were invented.

Trade on ASX or Cboe and the settlement of those transactions is managed today with a high degree of certainty and adherence to a T+2 discipline. However, many legal advisers insist on including redundant clauses in the bidder's statement inviting shareholders who believe they are entitled to be registered to lodge an impaired, makeshift form of acceptance that is arguably outside the operating terms of the bidder's offer. The unregistered buyer also has no personalised acceptance and transfer form and without a high degree clerical excellence can find themselves in a similar situation to Redowood Pty Limited. The various proceedings and appeals brought by Redowood Pty Limited against the bidder Mongoose Pty Limited[4] and its bidder registry, ASX-Perpetual (now Link Market Services)[5], demonstrate many dangers of all sides of the process not fully understanding the operating environment and of not executing the process correctly across many levels. Examination of the transcripts indicates the stockbrokers managing this client's order in such situations was not well informed about the best course of action for managing both the trade and subsequent acceptance of the takeover bid.

Today, anyone buying shares in a target security via ASX, or Cboe, with the intention to tender their purchased shares into an off-market takeover bid will always be in a position to know the status of both the bid conditions and with some degree of certainty the bidder's relevant interest (+/- 1%) at the time of their order is placed. The expectation will be that most of these investors will be buying directly through a stockbroker and the purchase will be registered in CHESS on their HIN.

As soon as the stockbroker settles the purchase with the market in CHESS batch settlement intraday on T+2, the controlling participant will be capable of acting on their client's instruction, depositing the purchased securities into the client's HIN and give an electronic takeover acceptance via CHESS that is immediately presented to the bidder's registry.

[4] http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/HCATrans/2005/660.html and http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCA/2005/32.html

[5] http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2006/334.html and http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCA/2007/286.html

Instead of the bidder's statement encouraging a fraught process, as demonstrated by Redowood P/L in the Mongoose Pty Ltd takeover bid and offer for Anaconda Nickel Ltd, the investor should be making deep enquiry and get informed and reliable instructions from their stockbroker's back office professionals about how the acceptance of the bid is to be managed for the securities they have purchased with the intent of accepting into the bid. Bidders should be assisting too by using better general instructions, not the boilerplate wording that is the current standard.

If the 'entitled to be registered' protection is inherited from either regulation or law, it should not be in place for a security that is capable of being managed through our robust clearing and settlement facility, CHESS. There may be a place for this concept in unlisted companies, but not listed companies.

The failure of Blue Circle Industries Plc's offer for Birmid Qualcast Plc in the UK [6] may be the most famous case of a bidder relying on the representations of an unregistered buyer and their bid failing.

Like in the UK the Australian bidder's registry has no sound method at its disposal to validate and verify the capacity of an unregistered buyer to give a good acceptance.

The information the bidder relies on when making announcements of its change of relevant interest is informed from the copy of target's register and the irrefutable proof of acceptance and application of an Offer Subposition the bidder receives from CHESS. A shareholder who will be registered on a CHESS holding can only give their acceptance up via their controlling participant and CHESS, from a registered and encumbered position.

If the requirements in Appendix 4 of the City Code, as it relates to the Receiving Agent's code of practice, were used as a template this will eliminate acceptances that cannot be proven or are doubtful as there is no observable link for any registry, including the target's own registry' between a seller and a buyer and none of the detail is either available to the bidder or allowed to be shared by the target's registry.

> *"(b) It is essential when determining the result of an offer under the Code that appropriate measures are adopted such that all parties to the offer may be confident that the result of the offer is arrived at by an objective procedure which, as far as possible, eliminates areas of doubt. This Code of Practice is designed to ensure that those acceptances and purchases which may be counted towards satisfying the acceptance condition and thus included in the certificate required by Note 7 on Rule 10.1 are properly identified to enable the receiving agent to provide the certificate. Receiving agents are also required to establish appropriate procedures such that acceptances and purchases can be checked against each other and between different categories so that no shareholding will be counted twice."*

Acceptance Facility

Similar issues will arise through the use of an Acceptance Facility, as it is proposed in *Attachment 3 to CP 365 : Draft instrument*, that extends into the retail layer of the target's register.

Though the intent of the proposal and previous attempts to operate similar functions is honourable I believe from my experience the application of an Acceptance Facility, accessible by retail shareholders, and environment it can operate in will lead to poor outcomes as insufficient, reliable information is available to all the responsible parties and there is a high risk that an acceptance and report of that acceptance will not be reliable.

[6] https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/report1989.pdf and https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1988-22.pdf

This is particularly so where the target is subject to two or more open competing bids or a bid that has not yet been declared unconditional. [7]Each bidder, through the information in the hands of the bidder's registry, is not aware of the extent a shareholder could over commit their holding. The process and information base at the disposal of each bidder and target is severely deficient to what is required to operate a reliable and informed Acceptance Facility at scale and with sufficient certainty.

The static copy of the target's register each bidder holds and the record the bidder carries is not sufficiently transparent, or discoverable, or available to or from each relevant party. So an unwitting retail shareholder can commit their stock to both bids, and an unfulfilled sale order and it could be counted twice by each bidder. The incentive for the retail shareholder is to have a 'bet' in each game, so present their stock to each bidder's offer.

The target is unaware of any overcommitted state and is incapable of communicating the overcommitted state to the respective bidder(s). The skilled application of an Institutional Acceptance Facility requires and applies additional layers of insight, control, diligence and reconciliation over acceptance intentions and operates with professional counterparts in a bespoke manner. An Acceptance Facility as outlined in *Attachment 3 to CP 365 : Draft instrument* and an Institutional Acceptance Facility are not interchangeable.

Whether the bidder can promise a shorter time for payment of bid consideration in its offer terms

As you note, it is common bidder strategy to commit to pay the offer consideration earlier than one month after the bid has been declared unconditional, or acceptance, to sweeten the terms and/or to hold withdrawal rights at bay when extending the offer period.

When managing the consideration payment terms for a bidder the bidder's registry is also managing:

- completion of takeover transfers with the target's share registry;
- securing confirmation the bidder's cash for payment in on hand;
- coordinating the issue of scrip consideration to accepting shareholders, or the nominee/trustee appointed for ineligible/small shareholders; and
- the practical limitations of consideration payment advice logistics.

These practical functions of a takeover bid should not be compromised by an overly ambitious accelerated payment regime, particularly if the offer will be declared unconditional well before the bidder gains the target ownership threshold to proceed to compulsory acquisition.

Compulsory acquisition – notice to dissenters

The reasonably new requirement on the bidder to electronically lodge its 6021/6022 notice via ASIC's lodgement platform has inadvertently created a compromised capacity for a bidder to meet their strict liability responsibilities to despatch the notices to dissenting shareholder by no later than the business day after notice is lodged with ASIC. This potential for failure is particularly evident where; print and mail resources are in short supply (in the annual general meeting season, dividend seasons and in the period between Christmas and New Year) and/or the pool of dissenters in the target register is large.

In the past the bidder's advisers would prepare a two page 6021 notice in parallel with the formal lodgement process and the registry expert input into the management of print and mail logistics.

[7] The competing takeover bids for Warrego Energy Ltd (WGO:ASX) made by Hancock Energy (PB) Pty Ltd and Strike West Holdings Pty Ltd, with Mineral Resources Limited taking a spoiling stake will be a case in point.

As the formal 6021 notice that is output by ASIC's lodgement process now extends to three pages, requiring two duplex pages (a 100% increase over the previous state) in the printing process, can only be produced as a consequence of lodgement with ASIC in the prescribed form the day, or days, of preparation that ensured the despatch as a personalised document could be managed on time is at risk. The risk of failure and the strict liability consequences is heightened when the pool of dissenters is large or the bidder's copy of the target register is in flux because of recently lodged takeover transfers or conversion of convertible securities and ensuing update by the target.

At a minimum, the 6021 notice output from the ASIC lodgement process should be:

- compressed to two pages; and
- make an allowance for the notice to be personalised printed and be used as the mailing medium.

or, the period for despatch following lodgement with ASIC extended by a business day, to reduce the prospect of strict liability penalties because of an unintended adverse impact created by a change of ASIC's process.

Cash and scrip consideration paid to ineligible foreign shareholders and small shareholders

It is common for a bidder to establish a nominee procedure for either or both ineligible foreign shareholders or small shareholders.

In the event a bidder is required to issue the share consideration into the name of a nominee for sale and the offer consideration also has a cash component the bidder will be challenged to make a timely and easy to negotiate combined cash and sale proceeds payment to the ineligible foreign or small shareholders shareholders in most circumstances.

Small shareholders in foreign countries are disadvantaged if they have to outlay bank fees and charges with their local bank to negotiate each A$ domestic cheque they receive.

Consider if dispensation can be given to aggregate the cash consideration and sale proceeds for ineligible foreign and small shareholders later than the by the normal deadline of, earlier of one month after the takeover contract becomes unconditional or 21 days after the end of the offer period, or allow the bidder to pay the cash consideration to the nominee as completion of their responsibilities and then the nominee makes a combined payment of cash consideration and the investor's share of net sale proceeds.

The definition of a small parcel also creates issues for the determination of affected shareholders and the management of the issue of scrip consideration to a nominee for sale. This is particularly the case when the bidder has declared their offer unconditional and is proceeding to pay away the offer consideration in multiple batches to meet an accelerated payment commitment. If the number of consideration shares that forms a small parcel changes with the market value of that consideration, the outcome for batches of small shareholders will differ across the bid period.

Acceptances received by the bidder for securities registered in a clearing and settlement facility

It appears that the intention of paragraphs 192 and 193 in the Consultation Paper is to improve certainty for both the target shareholder and the bidder.

192 [CO 13/521] modifies the Corporations Act so that, for the purposes of Ch 6 and 6C, an offer is taken to have been accepted in respect of securities registered in a clearing and settlement facility when:

> *(a) the bidder has received a written instruction or authority (or both) from a holder entitled to accept the offer (or a person with a right to be registered[8] as holder); and*
>
> *(b) the instruction or authority is given for the purpose, and has the effect, of enabling the bidder to instruct another person through the relevant clearing and settlement facility expectations of target holders that once they have delivered the bidder a completed acceptance form, they have accepted the offer.to effect acceptance of the offer.*

193 The purpose of the modification is to improve certainty for bidders and holders by clarifying the application of Ch 6 and 6C where a holder seeks to accept a takeover offer for securities registered in a clearing and settlement facility by returning a completed acceptance form to the bidder or its representative. The modification seeks to align the operation of Ch 6 with the

CHESS only allows the bidder to request an acceptance by CHESS Takeover Acceptance message from the controlling participant for a registered and unencumbered shareholder to accept the offer, not instruct. There are two distinct CHESS External Interface Specification messages[9] for each process and stakeholder and they are not interchangeable.

It is commonplace for the bidder's requests on holdings to be rejected by CHESS, in the event the:

- shareholder has sold down some of their holding but the bidder's copy register has not been updated; or
- HIN is locked; or
- holding is locked; or
- holding has a interest recorded against it in CHESS (an *Options Cover* subposition for example); or
- controlling participant has allowed the request to go unanswered and to be house kept by the CHESS end of day processes

the attempted request will be rejected by CHESS with only the house kept request being referred back to the controlling participant.

It is commonplace for the bidder's requests on otherwise 'available' holdings to be passed on to the shareholder's controlling participant by CHESS and to go unanswered and be house kept and deactivated by CHESS normal processes. Though the bidder's registry will retry some requests many times, some requests are belligerently ignored despite ASX Settlement Operating Rules requiring action. The bidder and its registry are unaware of other factors that would prevent the broker from accepting the offer, such as outstanding price based limit orders or debts owing.

ASX Settlement Operating Rules set out expectations on the controlling participant and the warranties and indemnities given in favour of the subject shareholder and bidder by the controlling participant if it refuses the request.

In each case above, though an acceptance form and an intention to draw a positive response from the controlling participant are in place the acceptance and the required Takeover Accepted subposition that permits all subsequent actions by the bidder in CHESS is not in place. Even if the target registry was served with a signed acceptance form in relation to CHESS holding it is not permitted to access that CHESS holding for the bidder.

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[8] The CS facility CHESS does permit a takeover acceptance message to be processed or queued by the bidder or controlling participant for a person with a right to be registered, only registered holders.

[9] Bidder can send only an *Offeror Takeover Acceptance* (message number 711-01) and Controlling Participant can only send a *Takeover Acceptance* (message number 031-01) see https://www.asxonline.com/public/documents/chess-external-interface-specifications.html

As a consequence, the theoretical acceptance cannot advance into a transfer of ownership into the bidder's name once its offer has been declared unconditional and the target shareholder will subsequently not be paid the offer consideration, except if the offer proceeds to compulsory acquisition.

The results for target holders with CHESS holdings would improve substantially if, instead of encouraging delivery of a completed acceptance form to the bidder, the holders deliver a completed acceptance form and/or written instruction to accept the offer to their controlling participant. If this direct course of action is taken the investor gets more flexible point to point delivery options and requires the controlling participant to act within the scheduled times carried in ASX Settlement Operating Rules and the warranties and indemnities in the rules and remedies are much more in favour of the investor.

The same concepts that apply to CHESS were intended to apply for CHESS Replacement, where the bidder with an acceptance form in hand can only request acceptance and expect a positive and timely response.

Stephen Dear