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M&A

JUNE 2011

M&A Newsletter – Year End Edition

THREE REASONS
to read this issue

1 You want to know what disclosure is required when announcing a scheme

2 You want to know what is required to show an "association" for the purpose of Chapter 6

3 You want to know more about managing your continuous disclosure and ASX's new guidance note

ALSO IN THIS ISSUE

- Impact of the James Hardie litigation on executives' liability

- ASIC's draft guidelines on prospectus disclosure

How can we improve?
We are always striving to improve our newsletters to make them more relevant to our target audience of investment bankers. We welcome your feedback on suggested themes/topics and any questions or general comments. We are not beyond bribing you – every person whose suggestion is implemented will receive a small gift from us. Contact the editors for feedback.

Editors
Jeremy Davis & Justin Fox

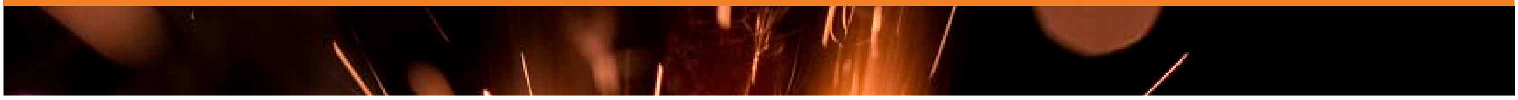
Jeremy Davis
Partner, Sydney
Tel +61 2 9210 6372
jeremy.davis@corrs.com.au

Jeremy specialises in public and private mergers and acquisitions, securities law, joint ventures and foreign investment into Australia. Jeremy has recently acted for BP on its acquisition of Reliance Petroleum and Foster's Group on the demerger of its wine business, Treasury Wine Estates.

Justin Fox
Partner, Melbourne
Tel +61 3 9672 3464
justin.fox@corrs.com.au

Justin practices corporate law with a focus on mergers and acquisitions. Justin has assisted clients in a diverse range of industries, including food and beverage, media and telecommunications, financial services, manufacturing, construction, property development, energy and resources and hospitality.

Want to know more?
We would be happy to share our insights on the latest in scheme technology and developments. To organise a seminar targeted at investment bankers and tailored for your organisation, please contact the editors.



Mecaila Chapman
Lawyer, Sydney

Mecaila is a mergers and acquisitions lawyer and has acted on a number of private and public M&A transactions and other corporate transactions.

Tel +61 2 9210 6158
mecaila.chapman@corrs.com.au

SCHEMES: IT MAY BE UNACCEPTABLE NOT TO DISCLOSE ALL TERMINATION RIGHTS

By Mecaila Chapman

NEED TO KNOW

- The Takeovers Panel found that termination of a scheme implementation agreement on the grounds of undisclosed termination rights constituted unacceptable circumstances.
- Parties should disclose all termination rights and other material terms at the time of announcement. The recent trend to disclose summaries is likely to be replaced with disclosure of the entire scheme implementation agreement.
- The acquirer and target have responsibility to ensure adequate disclosure.
- This case shows an increasing trend for the Takeovers Panel to get involved in schemes.

Background

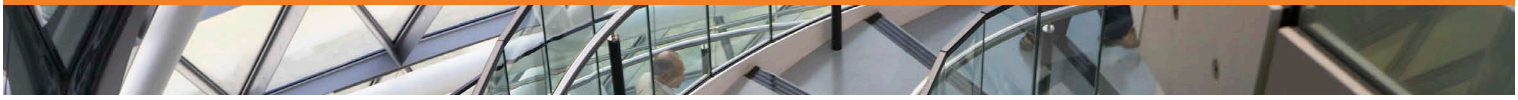
- In January 2011 BC Iron Limited (**BCI**) entered into a scheme implementation agreement with Regent Pacific Group Limited (**Regent**) in which Regent agreed to acquire all the shares in BCI for cash.
- Both BCI and Regent's announcements to the market contained a summary of the key terms of the agreement. However, neither announcement referred to Regent's right to terminate if its board changed or withdrew its recommendation.
- In March 2011 Regent sought to terminate the agreement on the basis that the Regent board had withdrawn its recommendation because of reported opposition to the deal by a major BCI shareholder.
- BCI challenged Regent's termination of the agreement.

Claims by BCI

- BCI applied to the Takeovers Panel for a declaration of unacceptable circumstances because the acquisition of BCI shares was not taking place in an efficient, competitive and informed market.

The decision

- In April 2011, the Takeovers Panel found that Regent's termination of the agreement on the basis of a changed board recommendation was unacceptable because the relevant termination right was not disclosed to the market before the termination took place.
- The Takeovers Panel found that the announcement by BCI should have included details of all termination rights.
- The Takeovers Panel stated that both the acquirer and the target have a responsibility for ensuring that the material terms, the disclosure of which is necessary to ensure an efficient, competitive and informed market for target shares, are in fact disclosed.
- The Takeovers Panel ordered that Regent was prohibited from terminating the agreement on the basis of the changed board recommendation.



BROCKMAN'S FAILURE TO OVERCOME THE "ASSOCIATION" HURDLE

By Stan Lewis and Jessica Au

Stan Lewis
Partner, Sydney

Stan specialises in major and complex litigation. His practice incorporates all aspects of corporate and securities litigation and advice including takeovers, securities transactions and investigations by regulatory bodies including ASIC, ASX and the ACCC.

Tel +61 2 9210 6955
stan.lewis@corrs.com.au

Jessica Au
Lawyer, Sydney

Jessica is a corporate and commercial lawyer who has been involved in a number of private and public M&A transactions. Recently, Jessica was part of the Corrs' team that acted for Foster's Group Ltd, in relation to the demerger of its beer and wine businesses.

Tel +61 2 9210 6478
jessica.au@corrs.com.au

NEED TO KNOW

- Associates acting in breach of Chapter 6 compromise the operation of an efficient and informed market.
- Allegations of association will, by their very nature, usually be very difficult to prove and frequently will rely on the Panel being required to draw inferences from patterns of behaviour, commercial logic and other evidence suggestive of association.
- In a recent Panel case, the applicant, Brockman, failed to demonstrate a relationship of association between a number of shareholders despite concerns expressed by the Panel about certain coincidences in the case.
- Panel applicants who allege association face the difficulty of having to demonstrate a "sufficient body of material" from which the Panel can draw inferences of association. Demonstrating that someone has acted in a manner that is uncommercial or lacks a commercially viable explanation is often an important starting point.

What constitutes an 'association'?

The 'associates' definition under the Corporations Act is broad. Applicants in Panel association cases often allege an 'association' under subsections 12(2)(b) and 12(2)(c) of the Corporations Act, namely:

- there is a relevant agreement for the purpose of controlling or influencing the composition of the company's board or the conduct of the company's affairs; or
- the parties are acting, or proposing to act, in concert in relation to the company's affairs.

If an 'association' exists between A and B in relation to company C, it means that A and B's shareholdings in company C must be aggregated for the purposes of the 20% takeover threshold in Chapter 6 and also the substantial shareholding provisions.

Brockman's Panel application

On 1 March 2010, Wah Nam lodged a substantial holding notice indicating that it had 19.90% voting power in Brockman; it subsequently increased its shareholding to 22.63% in October 2010 under the 'creep' exemption. A conditional takeover bid by Wah Nam for Brockman was subsequently announced to ASX on 11 November 2010.

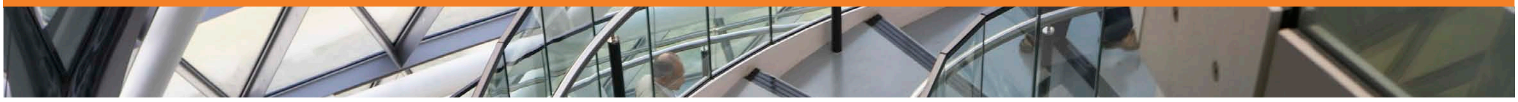
Brockman applied to the Panel on 10 January 2011 seeking a declaration of unacceptable circumstances. Brockman alleged that, in addition to the 22.63% of Brockman directly held by Wah Nam, a further 7.1% and as much as 17.57% (inclusive of the 7.1%) may be held by Wah Nam's associates.

"Sufficient body of material"

The Panel acknowledged the Panel's statements in *Winepros Limited* that allegations of association will, by their very nature, usually be very difficult to prove. It is very difficult to provide direct evidence of the existence of association. On that basis, the Panel will frequently be required to draw inferences from patterns of behaviour, commercial logic and other evidence suggestive of association.

The Panel also acknowledged that the starting point is for an applicant to demonstrate a "sufficient body of material" to satisfy the Panel that association can be established. Although the Panel expressed concern about certain aspects of the Brockman matter, it declined to make a declaration of unacceptable circumstances.

Recently, in *Bentley Capital Limited*, the Panel restated what it had said in previous association cases, that circumstances which



are relevant to establishing an association include:

(a) a shared goal or purpose;

(b) prior collaborative conduct;

(c) structural links;

(d) common investments and dealings;

(e) common knowledge of relevant facts; and

(f) actions which are uncommercial.

The applicants in *Bentley Capital* were also unable to demonstrate a sufficient body of material to satisfy the Panel that it could draw the necessary inferences and find the alleged associations.

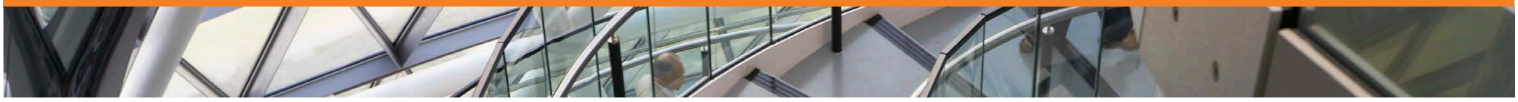
Earlier "association" cases

In contrast, the applicants in two earlier Panel cases this year were successful in proving association between shareholders. The evidence in *Viento Group Ltd* showed unexplained and inadequately disclosed purchase transactions and trust arrangements, personal and business links, joint attempts to secure a board position, inadequate substantial holder and tracing notices, and confusing or incomplete answers from the parties. The Panel found that the cumulative effect of the material enabled it to draw the necessary inferences of association between the parties. In *CMI Limited*, the evidence of personal relationships, a substantial financial gift to fund the share purchase, cross beneficiaries under trust arrangements, and the incomplete and vague information provided by the respondents regarding the share purchase gave rise to a "reasonable and definite inference" of association.

In both *Viento* and *CMI Limited* cases, there were a small number of parties involved and the evidence was detailed and compelling. In contrast, Brockman's case involved several more parties and some of Brockman's shares were purchased by the relevant parties several months before Wah Nam's bid. Brockman sought to rely on evidence of personal and commercial relationships, loans between parties to fund the acquisition of Brockman's shares, and a common address shared by certain shareholders. However, the Panel found that the evidence was insufficient to establish association between the parties.

Proving association is tricky for Panel applicants

As the Brockman case demonstrates, Panel applicants face the difficulty of demonstrating "a sufficient body of material" from which inferences can be drawn and findings made regarding relationships of association. Proceedings before the Panel are conducted quickly to avoid delaying commercial transactions; the process usually consists of written submissions and limited documentary evidence. This process by its nature can make proving the existence of an association very difficult for the applicant. This could potentially mean associates acting in breach of Chapter 6 could continue to compromise the operation of an efficient and informed market.



Clare Brown
Senior Associate, Sydney

Clare is a senior associate in the public securities team in Corrs' Sydney Corporate Advisory Group. Clare has broad experience in cross-border and domestic corporate transactions including advising on public acquisitions, equity and hybrid security fundraising transactions, joint ventures and private business sales and acquisitions. Clare is also experienced in advising clients on ASX listing rule matters.

Tel +61 2 9210 6244
clare.brown@corrs.com.au

MANAGING CONTINUOUS DISCLOSURE – TRADING HALTS, VOLUNTARY SUSPENSIONS AND ASX'S NEW GUIDANCE NOTE

By Clare Brown

NEED TO KNOW

- ASX's new Guidance Note provides a better insight into ASX's policy for granting trading halts and the circumstances where a voluntary suspension is the preferred approach to managing an entity's continuous disclosure obligations.
- ASX insists that a voluntary suspension should not been seen as "a less attractive option" for issuers than a trading halt, where the issuer is in a price-sensitive situation and a two day halt may not afford enough time. To this end, ASX confirmed that "back-to-back" trading halts will not usually be granted.
- Notwithstanding ASX's approach, voluntary suspensions can have potential adverse consequences on a company's ability to raise funds.

ASX issued a new Guidance Note in March which better details its policy on granting trading halts and discusses how entities should use trading halts and voluntary suspensions to manage their continuous disclosure obligations (see Guidance Note 16 to the ASX Listing Rules).

A trading halt is a temporary break in trading in an entity's securities which does not involve a formal suspension from quotation. A single trading halt may last for up to two trading days, and a "back-to-back" trading halt may last for up to four trading days (eg two consecutive trading halts).

Generally, a company will ask ASX to impose a trading halt where the confidentiality of a transaction or matter has been lost but the company is not in a position to make a formal announcement in accordance with its continuous disclosure obligations under the ASX Listing Rules and the Corporations Act. However, trading halts are not granted automatically by ASX.

The new Guidance Note provides some useful examples where ASX would be likely to grant a trading halt. These include:

- A company is in the final stages of confidential negotiations with a third party regarding the acquisition of a material asset and there is accurate speculation in the media about the transaction (ie the negotiations are no longer confidential).

  In these circumstances, ASX says it would likely grant a trading halt to allow the company time to complete negotiations and make an announcement to the market about the concluded transaction. It would be expected that the trading halt request, which would be released to the market, would state that the company is in negotiations with the third party.

- A company is conducting a bookbuild as part of a significant fundraising.

  In these circumstances, ASX says it would likely grant a trading halt to allow the company time to conduct the bookbuild process. The trading halt request would need to mention the proposed issue of securities and the timetable for conclusion of the bookbuild.

In each of the above cases, the trading halt would be granted for no longer than was necessary to complete the process – up to a maximum of two trading days. ASX will only consider a "back-to-back" trading halt in "certain exceptional circumstances". Unfortunately, the new Guidance Note does not expand on what may constitute "exceptional circumstances", however, it does say that ASX has only permitted back-to-back halts for issues of securities that:

- are significant in the context of the entity's issued capital;
- are essentially pro rata to all holders (eg an accelerated offering conducted in two stages, such as a Jumbo offer);
- involve the use of a bookbuild process and requires a halt in trading of more than two, but not more than four, trading days to be implemented.

ASX's reluctance to grant "back-to-back" trading halts is due to the availability of voluntary suspensions. The new Guidance Note advises that if a company anticipates that its securities will need to be halted for a longer period than two trading days, the appropriate course is for the entity to request a voluntary suspension, rather than a trading halt.

As a voluntary suspension is not subject to the same time constraints as a trading halt (a voluntary suspension can be for any length of time), a suspension appears to be an attractive alternative for companies where a trading halt would be too short. However, as the Guidance Note acknowledges, the main problem with a suspension is that it can hinder a company's future ability to raise funds.

If a company's securities are suspended from trading on ASX for more than 5 days in 12 months (this does not include any days in trading halt), it will be unable to raise funds through "low doc" rights issues and security purchase plans (although ASIC may be prepared to grant relief if it believes that the suspension has not prevented the market from being fully informed). In addition, the company will not be able to issue a "cleansing notice" to allow for the secondary sale of securities issued under a placement. This means that the company's fundraising activities would (in the absence of ASIC relief) need to be conducted using a prospectus or product disclosure statement, which significantly increases costs and complications for the issuer.

Aspects of the James Hardie litigation are a warning to any executive who takes a leading role during a transaction.

EXECUTIVES' LIABILITY DURING TRANSACTIONS: IMPACT OF THE JAMES HARDIE LITIGATION

By Jeremy McCarthy and James Rankin

NEED TO KNOW

- Senior managers or executives of a business who take a leading role in a transaction can become personally liable for fault.
- This potential for liability can be imposed by Australian courts regardless of the senior manager or executive's particular job description.
- Senior managers and executives who take a leading role in a transaction should remember to provide frank advice to Board and to seek professional advice about sensitive issues.

The New South Wales Court of Appeal has recently found that, during an internal restructure of James Hardie International Ltd in 2001, the Chief Financial Officer (**CFO**) and General Counsel and Company Secretary (**GC-CS**) were both 'officers' and breached their obligations to reasonably carry out their duties under the *Corporations Act*.*

Who is an officer and what do they have to do?

An "officer" under the *Corporations Act* is, generally, a senior manager or executive who:

- makes material decisions in relation to that transaction;
- provides advice directly to the board or a Chief Executive Officer;
- maintains intimate knowledge of that transaction; and/or
- takes leadership over aspects of that transaction.

The Court stressed that certain employees, such as a senior manager or executive, can be deemed to be officers under the *Corporations Act* due to what that they actually do day-to-day, rather than what is provided in their job description.

An officer who fails to adequately carry out his or her role 'reasonably' and 'with due diligence', can become personally liable.

Pitfalls in the James Hardie Litigation

During the 2001 restructure, the CFO and GC-CS both made key decisions, advised the board directly and had detailed knowledge of the transaction. The CFO advised the board in relation to the financial model and the GC-CS managed continuous disclosure responsibilities. The Court accordingly found that both the CFO and GC-CS were officers of James Hardie.

The Court found that the CFO breached his duty during the 2001 restructure by failing to advise the board on key aspects of the transaction's financial model. The GC-CS breached his duty by failing to provide (or seek) advice on a particular continuous disclosure issue and also failed to advise the Chief Executive Officer or Board of this issue.

This case is a warning to any senior manager or executive who takes a leading role in a transaction. Officers must have the courage to provide their board with frank advice, involving good or bad news. If an officer is unsure about an issue, they should seek professional advice.

**Authors' Note: certain aspects of the James Hardie Litigation, including the General Counsel and Company Secretary's liability, are currently subject to a High Court Appeal. The points discussed in relation to the CFO, however, have not been appealed.*

Jeremy McCarthy
Partner, Melbourne

Jeremy practises in corporate, commercial and securities law, with particular expertise in mergers and acquisitions. Recently, Jeremy was the lead advisor on AIM-listed Plantic Technologies Ltd's scheme of arrangement, which involved many complex cross-border securities law issues.

Tel +61 3 9672 3310
jeremy.mccarthy@corrs.com.au

James Rankin
Lawyer, Melbourne

James is a mergers and acquisitions lawyer who has acted in a range of public and private M&A transactions. Recently, James was part of Corrs' team which acted for Southern Cross Media Group in its takeover of Austereo Group Limited.

Tel +61 3 9672 3035
james.rankin@corrs.com.au

Laura Keily
Senior Associate, Melbourne

Laura practices in mergers and acquisitions, with particular expertise in schemes of arrangement, takeovers and negotiated mergers and acquisitions. Recently, Laura advised on Southern Cross Media Group Ltd's takeover of Austereo Group Ltd and associated equity raising.

Tel +61 3 9672 3414
laura.keily@corrs.com.au

ASIC'S NEW GUIDANCE – DISCLOSE MORE, WRITE LESS!

By Laura Keily

NEED TO KNOW

- ASIC has sought comment on draft guidelines which are aimed at making prospectuses more accessible to retail investors.
- Proposed changes include the requirement to include a summary of the business model and tailored risk disclosure.
- The new guidelines will apply to other documents, including bidder's statements and scheme booklets where securities are offered as consideration for a bid.

On 12 April 2011, ASIC released a draft Regulatory Guide (**RG**) entitled 'Prospectus Disclosure: improving disclosure for retail investors'. The RG includes further guidelines on prospectus content and presentation.

The draft RG is heavy on new disclosure requirements. In particular, it suggests that issuers should include a detailed explanation of the issuer's business model. Specifically, ASIC suggests that an issuer should describe how it proposes to generate income or capital growth for investors and the linkages between various components of the business model and the disclosed risks.

There is also further guidance on the vexed issue of how risks should be disclosed. The RG suggests for example, that risks should be grouped into categories (eg industry risks, company specific risks, etc) and that issuers should provide an indication of the likelihood or otherwise of a risk materialising. This later requirement could prove a challenging exercise for due diligence committees, as industry practice has been to disclose risks which could have a catastrophic effect on the business (eg natural disasters) notwithstanding that they may be fairly remote.

Predictably, the draft RG also stresses the need to adopt plain English drafting, concise language and clearer definitions in prospectuses.

The message therefore seems to be 'disclose more – but write less'. It would not surprise however if cautious issuers choose to respond to the new guidelines by including more rather than less information.

In bad news for the creative houses, ASIC has also voiced its disapproval of excessive photographs in prospectuses. The RG specifically notes that any pictures should not appear until after the investment overview. Readers who are prepared to plough on through the detail can apparently still be rewarded with modest graphic relief. Only time will tell whether readers will thank ultimately ASIC for their intervention on this point.

For further information, please contact:

BRISBANE

Teresa Handicott
Tel +61 7 3228 9458
teresa.handicott@corrs.com.au

Stephanie Daveson
Tel +61 7 3228 9493
stephanie.daveson@corrs.com.au

Jeremy Horwood
Tel +61 7 3228 9790
jeremy.horwood@corrs.com.au

MELBOURNE

Justin Fox
Tel +61 3 9672 3464
justin.fox@corrs.com.au

Peter Ickeringill
Tel +61 3 9672 3495
peter.ickeringill@corrs.com.au

Naomi Lawrie
Tel +61 3 9672 3215
naomi.lawrie@corrs.com.au

Jeremy McCarthy
Tel +61 3 9672 3310
jeremy.mccarthy@corrs.com.au

PERTH

Robert Franklyn
Tel +61 9 9460 1706
robert.franklyn@corrs.com.au

Russell Philip
Tel +61 9 9460 1673
russell.philip@corrs.com.au

Christian Owen
Tel +61 9 9460 1708
christian.owen@corrs.com.au

SYDNEY

Jeremy Davis
Tel +61 2 9210 6372
jeremy.davis@corrs.com.au

Braddon Jolley
Tel +61 2 9210 6945
braddon.jolley@corrs.com.au

Byron Koster
Tel +61 2 9210 6533
byron.koster@corrs.com.au

Iain Laughland
Tel +61 2 9210 6506
iain.laughland@corrs.com.au

Richard Lewis
Tel +61 2 9210 6540
richard.lewis@corrs.com.au

Andrew Lumsden
Tel +61 2 9210 6385
andrew.lumsden@corrs.com.au

Sandy Mak
Tel +61 2 9210 6171
sandy.mak@corrs.com.au

James Rozsa
Tel +61 2 9210 6708
james.rozsa@corrs.com.au

Steve Johns
Tel +61 2 9210 6203
steve.johns@corrs.com.au

SYDNEY
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Tel +61 2 9210 6500
Fax +61 2 9210 6611

MELBOURNE
Bourke Place
600 Bourke Street
Melbourne VIC 3000
Tel +61 3 9672 3000
Fax +61 3 9672 3010

BRISBANE
Waterfront Place
1 Eagle Street
Brisbane QLD 4000
Tel +61 7 3228 9333
Fax +61 7 3228 9444

PERTH
Woodside Plaza
240 St George's Terrace
Perth WA 6000
Tel +61 8 9460 1666
Fax +61 8 9460 1667