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# Takeovers and public securities

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## GLOUCESTER COAL: SHAREHOLDER RIGHTS, COMPETING BIDS AND THE ROLE OF DIRECTORS IN REVERSE TAKEOVERS

### INTRODUCTION

In *Gloucester Coal Ltd 01* [2009] ATP 6 and the subsequent decision of the Review Panel in *Gloucester Coal Ltd 01R(a) and (b)* [2009] ATP 9 (*Gloucester Coal*),<sup>1</sup> the Takeovers Panel was asked to consider the nature of shareholder rights, the status of competing bids and the proper role of directors in the reverse takeover context.

Broadly defined, a reverse takeover occurs when a bidding company makes an offer for a company larger than itself, offering shares in the company as consideration. As is often the case, following the issue of shares, the controllers of the target finish with a controlling interest in the bidding company, bypassing the need for bidder shareholder approval.

Reverse takeovers are considered an important means of facilitating takeovers that would otherwise fail on account of shareholder dissent.<sup>2</sup> Circumventing a dissentient shareholder with a blocking stake in the bidder was indeed the primary motivation underlying the reverse takeover structure utilised in *Gloucester Coal*: “If the transaction could not have been structured in this way, or if the deal was subject to the approval of [the bidder’s] shareholders, there would simply have been no deal.”<sup>3</sup>

In assessing the merger, both the Initial Panel and Review Panel were evidently concerned to strike an appropriate balance between the facilitation of takeovers, the protection of shareholder rights and the preservation of a competitive market for corporate control.

Many commentators have praised the Review Panel’s decision for facilitating a competitive market by opening up the reverse merger arrangement to other proposals aimed at the bidder itself, and in doing so delivering greater shareholder value. In addition, while the Review Panel did not consider bidder shareholder approval was required in every reverse takeover, it gave a strong indication that it will closely scrutinise reverse takeovers that disenfranchise bidder shareholders where they affect a change of control in the bidder.

However, not everyone is applauding the decision. Some commentators have expressed criticism at the Review Panel’s decision to bestow on the board of the bidding entity full discretion in deciding between competing proposals, thus wresting the control decision from shareholders contrary to established principle. Despite the differing opinions, there is consensus among practitioners that the decisions of the Takeovers Panel leave a number of questions unanswered. For reverse takeover proponents, this uncertainty is likely to mean that future transaction structuring will involve some degree of guesswork.

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<sup>1</sup> In this note, a reference to the “Initial Panel” is a reference to the decision of the Takeovers Panel in *Gloucester Coal Ltd 01* [2009] ATP 6, and a reference to the “Review Panel” is a reference to the decision of the Takeovers Panel in *Gloucester Coal Ltd 01R(a) and (b)* [2009] ATP 9.

<sup>2</sup> Reverse takeovers have also at times been utilised by privately held enterprises seeking a public listing without the associated financial and time-related costs of an initial public offering. In this situation, the private company seeking the listing will search out a publicly traded listed company. Upon acquisition, there is a change of control in the listed company and the private company will become the controller of the listed entity. The path provided to listing is commonly referred to as a “backdoor exchange listing”. In Australia, the ASX listing rules have been tightened to ensure that they are not circumvented by structures utilising existing vehicles already listed on the exchange. Listing Rule 11.1 requires that, where the ASX considers it appropriate, admission criteria applied to new exchange listings will also be applied to listed entities that propose a significant change to the nature or scale of its activities.

This requirement, in effect since 2000, has to a large extent mitigated the motivation to employ a reverse takeover structure to avoid the listing rules applicable to new public listings.

<sup>3</sup> Submission of *Gloucester Coal Ltd* to the Takeovers Panel as quoted in *Gloucester Coal Ltd 01* [2009] ATP 6 at [25].

This note commences by briefly outlining the current Australian regulatory framework governing reverse takeovers, before discussing the background to *Gloucester Coal*. Following this, the divergent decisions of both the Initial Panel and Review Panel are analysed and evaluated.

## THE CURRENT LEGAL REGIME GOVERNING REVERSE TAKEOVERS

The Australian regulatory framework governing reverse takeovers is complex and involves the interaction of a number of distinct yet interwoven legal regimes.

Takeovers are regulated under Ch 6 of the *Corporations Act 2001* (Cth) (the Act).<sup>4</sup> Reverse takeovers are facilitated by the bidder's reliance on item 4 of s 611 which provides an exemption from the general prohibition relating to the acquisition of shares in s 606 where the bidder's scrip constituted, or formed part of, the consideration for the takeover offer.

Although permitted under the Act, the Australian Securities and Investments Commission (ASIC) has published guidance indicating that a reverse takeover or a scheme of arrangement having a reverse takeover effect is likely to raise issues of concern, especially where the shareholders of the acquiring company will not be given the opportunity to ratify the proposal.<sup>5</sup>

Furthermore, if the effect of the proposed transaction is contrary to the Eggleston Principles embodied in s 602, the Takeovers Panel has broad powers to declare the circumstances of the transaction unacceptable even if no provision of Ch 6 has been contravened.<sup>6</sup>

In entering into a change of control transaction, directors will be bound by the same fiduciary and statutory obligations that regulate their conduct generally. Non-compliance with directors' duties is not the primary concern of the Takeovers Panel,<sup>7</sup> but potential contraventions may be subject to scrutiny by the courts following a bid.<sup>8</sup> In the reverse takeover context, directors' duties will be particularly relevant where board action precludes alternative bids for the company and that action is not ratified by shareholders.<sup>9</sup>

The Australian Securities Exchange (ASX) listing rules provide another layer of regulation, imposing shareholder approval requirements in Chs 7, 10 and 11 on listed companies in prescribed

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<sup>4</sup> In this note, all reference to a section, Chapter or Part of legislation will be a reference to a section, Chapter or Part of the *Corporations Act 2001* (Cth) unless otherwise stated.

<sup>5</sup> ASIC, *Regulatory Guide 60* (25 February 2008) at [60.9]; ASIC, *Regulatory Guide 142* (4 August 1999) at [142.9]. Schemes of arrangement structured to have a reverse takeover effect may encounter difficulties gaining approval. Section 411(17) provides that court approval of the scheme of arrangement must not be granted unless the court is satisfied that the arrangement has not been made for the purpose of enabling any person to avoid the provisions of Ch 6, or ASIC has given written notice to the court that it has no objections to the proposed scheme. If unable to obtain ASIC certification, the acquiring company will need to persuade the court that shareholders are not being disadvantaged by the transaction proceeding via a scheme of arrangement rather than under Ch 6. This may be a difficult task where the scheme is being utilised to disenfranchise a blocking shareholder who may otherwise have had the capacity to frustrate the bid had it been implemented via Ch 6.

<sup>6</sup> *Corporations Act 2001* (Cth), s 657A. The Takeovers Panel's draft rewrite of Guidance Note 1 (released 20 April 2010) provides several examples of possible unacceptable circumstances, including "a change of control which either disenfranchises shareholders or does not meet the policy of chapter 6 (even if strictly it satisfied item 4 of section 611 – acquisitions that result from acceptance of a bid)": Takeovers Panel, *Rewrite of GN 1 on Unacceptable Circumstances and Draft GN on Recommendations and Undervalue Statements* (20 April 2010), <http://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=consultation/034.htm&pageID=&Year> viewed 22 April 2010.

<sup>7</sup> See Takeovers Panel, *Guidance Note 19: Insider Participation in Control Transactions* (18 December 2007) at [4]-[7]: "The Panel expects that all relevant parties will comply with their legal, fiduciary and statutory duties (and seek advice on these as required), but its primary concern is to determine whether unacceptable circumstances exist in the context of a takeover bid, not to determine whether there has been a breach of directors' or employees' duties or other obligations under the law. The Panel does not regard it as being its role to determine and enforce such duties and obligations."

<sup>8</sup> The restrictions on court proceedings in ss 659B and 659C have the principal object of making the Panel the main forum for resolving disputes about a takeover bid until the bid period has ended (s 659A).

<sup>9</sup> See Sweeney SC, "Target Directors' Duties: The Imposing Spectre of Delaware" in "Takeovers and Public Securities" (2008) 26 C&SLJ 114. Sweeney observed (at 126): "Given the current environment, directors of target companies should ensure that all possibilities have been explored or alternatively, that other potential offers are not impeded or excluded. Directors will need to exercise great caution in relation to exclusivity clauses to ensure that they do not stifle competition in the bidding process." However, following the decision of the Federal Court of Australia in *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35; [2007] FCA 963, it may be open to directors to modify

circumstances unless a waiver from the ASX is obtained.<sup>10</sup> Listing Rule 7.1 is of particular relevance in the reverse takeover context, prohibiting a listed company from issuing, in any 12 month rolling period, ordinary securities which represent more than 15% of the issued ordinary share capital of the company. Reverse takeover proponents will generally seek to rely on Exception 5 in Listing Rule 7.2 which exempts issues under an off-market bid or scheme of arrangement. The effect of the exemption is to deny bidder shareholders a vote in respect of the issue of a large non-pro rata stake in the bidding entity. In contrast, target shareholders, in deciding whether or not to accept the offer, are given a direct say in the outcome of the transaction. Where applicable, regard must also be had to relevant regulatory approvals including under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) and s 50 of the *Trade Practices Act 1974* (Cth) where the bidder and the target operate in the same business markets.

## FACTUAL BACKGROUND

Gloucester Coal Ltd (Gloucester) and Whitehaven Coal Ltd (Whitehaven) are coal mining and exploration companies incorporated in Australia and listed on the ASX.<sup>11</sup> Noble Group Ltd (Noble) is an international supply chain management company listed on the Singapore Exchange.<sup>12</sup>

On 20 February 2009, Gloucester and Whitehaven published a joint announcement relating to an agreed merger to be implemented via an off-market scrip takeover offer by Gloucester for all of the shares in Whitehaven (Whitehaven merger). Offer terms provided that Whitehaven shareholders were to receive one Gloucester share for every 2.45 Whitehaven shares. As at 19 February 2009, the market capitalisation of Gloucester and Whitehaven was A\$268 million and A\$619 million respectively: see *Gloucester Coal Ltd 01* [2009] ATP 6 at [6]. The size disparity of the firms and the planned board and management structure of the merged entity indicated that the merger was in effect a reverse takeover.<sup>13</sup> At the time the Whitehaven merger was announced, Noble was Gloucester's largest shareholder with 21.7% (at [5]). Both Whitehaven and Gloucester acknowledged in their submissions to the Takeovers Panel that avoiding Noble's blocking stake in Gloucester was the primary reason for structuring the transaction as a reverse takeover (at [25]).

The Merger Implementation Agreement (MIA) made the offer conditional on, among other things, at least 80% acceptance by Whitehaven shareholders and Foreign Investment Review Board (FIRB) approval.<sup>14</sup> Minimum acceptance was expected to be reached. At the time, public documents indicated that Whitehaven directors and their related entities held approximately 74% of Whitehaven shares. The target statement recommended the Gloucester bid to Whitehaven shareholders and indicated that Whitehaven directors would accept the offer provided that a superior proposal for Whitehaven did not emerge. In addition, a number of Whitehaven directors entered into pre-bid acceptance deeds in respect of 19.9% of shares in Whitehaven.

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aspects of the fiduciary duties owed to company shareholders via exclusionary clauses inserted in the company's constitution. This will depend on whether the court is willing to extend the principles established in *Citigroup* in relation to a fiduciary relationship established on a contractual basis to an established fiduciary category such as shareholder/director.

<sup>10</sup> Listing Rule 11.1 will apply in circumstances where the proposed transaction is likely to result in a significant change to the nature or scale of the listed entity's activities. ASX, *Guidance Note 12* (September 2008) at [15] indicates that compliance will not be required where both parties are listed on the ASX.

<sup>11</sup> Gloucester Listing Code (ASX: GCL); Whitehaven Listing Code (ASX: WHC).

<sup>12</sup> Noble Listing Code (SGX: NOBL).

<sup>13</sup> For an initial period the board of the merged entity would have consisted of the current directors of both companies, meaning Whitehaven directors would outnumber Gloucester directors seven to five. Both the chairman and the managing director of Whitehaven would have held their respective roles in the merged entity: see Gloucester Coal Ltd and Whitehaven Coal Ltd, "Gloucester and Whitehaven Announce Merger", *ASX Market Release* (19 February 2009), <http://www.asx.com.au/asxpdf/20090220/pdf/31g4y777dgywys.pdf> viewed 13 November 2009.

<sup>14</sup> On 19 March 2009, FIRB approval for the Whitehaven merger was received via a statement of no objection: Gloucester Coal Ltd, "FIRB Approval Received", *ASX Market Release* (19 March 2009), <http://www.asx.com.au/asxpdf/20090319/pdf/31gp5txyjl8dt.pdf> viewed 15 November 2009.

Following the merger announcement, Noble submitted an all cash bid for Gloucester at \$4.85 a share and conditional on the Whitehaven merger not proceeding.<sup>15</sup> Noble also applied to the Takeovers Panel seeking a declaration of unacceptable circumstances under s 657A in relation to the planned Whitehaven merger.

Before the Panel, Noble submitted that the terms of the MIA, which required Gloucester to make a bid announcement in an agreed form, locked Gloucester into the merger as Gloucester's bid did not contain a fiduciary out in the case that a superior offer for Gloucester emerged.

## INITIAL PANEL DECISION

The Panel at first instance made a declaration of unacceptable circumstances and ordered that the Whitehaven merger be subject to approval by Gloucester's shareholders with Whitehaven directors and their associates excluded from voting.

The Panel concluded that the structure of the bid deprived Gloucester shareholders of the opportunity to decide whether or not the merger, which was regarded as having an effect or potential effect on control of the company,<sup>16</sup> should proceed. In the alternative, the Panel held that the terms of Gloucester's bid announcement meant that the merger would operate in an anti-competitive environment, by preventing an auction for control of Gloucester.

## REVIEW PANEL DECISION

Gloucester and Whitehaven applied to have the Panel's decision reviewed. The Review Panel also made a declaration of unacceptable circumstances, albeit on different grounds. Importantly, the decision of the Review Panel was based on significantly different factual findings to that of the Initial Panel.<sup>17</sup> The changed factual circumstances meant that the Review Panel did not consider that the changes in shareholdings in the post-merger entity would amount to a change of control or would be of a sufficient "nature or scale" to have an effect on control giving rise to unacceptable circumstances.

Instead, the Review Panel reached the conclusion that the restrictive arrangement between Gloucester and Whitehaven constituted a "lock-up device". It declared unacceptable circumstances on the basis that the restrictive arrangement prevented the "acquisition of control over Gloucester shares taking place in an efficient, competitive and informed market" (at [60]). Furthermore, Gloucester shareholders "[did] not all have a reasonable and equal opportunity to participate in the benefits accruing to Gloucester shareholders through an alternative proposal" (at [60]). The Review Panel

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<sup>15</sup> Noble's bid was also conditional on FIRB approval being obtained. Noble received FIRB approval on 20 March 2009: *Gloucester Coal Ltd 01* [2009] ATP 6 at [7]. Interestingly, on 21 September 2009 Noble and the Chinese Investment Corporation (CIC), a Chinese sovereign wealth fund, entered into an Investment and Cooperation Agreement whereby CIC would acquire 573 million shares in Noble for total consideration of approximately US\$850 million. The stake represented an interest of 14.9% in Noble. FIRB approval was not sought on the likely basis that the investment was not a "direct investment". The Australian Government's Foreign Investment Policy dated September 2009 at [10] requires all direct investments by foreign governments or their agencies (including sovereign wealth funds) irrespective of size to be notified for FIRB approval: see Australian Government, Treasury, *Australia's Foreign Investment Policy* (September 2009), [http://www.firb.gov.au/content/downloads/Australia's\\_Foreign\\_Investment\\_Policy\\_September\\_2009.pdf](http://www.firb.gov.au/content/downloads/Australia's_Foreign_Investment_Policy_September_2009.pdf) viewed 15 November 2009. See further Freed J, "Defence Blocks Chinese Bid", *The Age* (23 September 2009).

<sup>16</sup> Based on the information before it, the Initial Panel formed the view that Whitehaven directors and their associates collectively controlled 74% of Whitehaven's shares pre-merger. Therefore, had the merger proceeded, the Panel found that Whitehaven directors and their associates would control approximately 51% of the post-merger entity: *Gloucester Coal Ltd 01* [2009] ATP 6 at [17], [26].

<sup>17</sup> Following the Initial Panel's decision, Whitehaven lodged a notice with ASX and amended public statements correcting previous statements setting out the relevant interests of Whitehaven's directors and their associates in Whitehaven. The notice specified that collectively the directors and their associates had a relevant interest in 33.67% and not 74% of Whitehaven: see *Gloucester Coal Ltd 01R(a) and (b)* [2009] ATP 9 at [6]. See also Whitehaven Coal Ltd, *Appendix 3X (Initial Director's Interest Notice) and Appendix 3Y (Change of Director's Interest Notice)* (25 March 2009), <http://www.asx.com.au/asxpdf/20090325/pdf/31grskvt0n5wcn.pdf> viewed 15 November 2009. See also accompanying media release, <http://www.asx.com.au/asxpdf/20090325/pdf/31grnc9f9rsv7z.pdf> viewed 15 November 2009.

provided a fiduciary out for Gloucester directors, by ordering a condition in the bid allowing Gloucester directors to consider superior proposals made for Gloucester.<sup>18</sup>

## SUBSEQUENT EVENTS

On 29 April 2009, the day the Review Panel made its declaration and orders, the Gloucester board gave notice stating its view that the Whitehaven merger remained in the best interests of shareholders.<sup>19</sup> On 5 May 2009, Noble increased its cash offer for Gloucester from \$4.85 a share to \$6.<sup>20</sup> On 12 May 2009, Noble commenced proceedings in the High Court of Australia for judicial review of the Review Panel's decision.<sup>21</sup> Subsequently, Gloucester appointed an independent expert to assess Noble's revised offer. On 13 May 2009, the Takeovers Panel, responding to Noble's application, varied the Review Panel's orders setting a deadline for release of the expert's report and a separate deadline for the Gloucester board to announce their view as to whether Noble's offer constituted a superior proposal. On 15 May 2009, Noble increased its offer to \$7 a share. Later that day, the Gloucester board announced that it had unanimously formed the view that the revised Noble offer was a superior proposal being more in the interests of Gloucester shareholders. Noble subsequently discontinued proceedings in the High Court.

## ANALYSIS

### Shareholder approval

Due to the Initial Panel's findings of fact, the question whether a change of control had occurred in Gloucester was uncontroversial.<sup>22</sup> On this basis, the Initial Panel concluded that the Whitehaven merger was a reverse takeover that would have a change in or effect on control giving rise to unacceptable circumstances. It considered the merger structure was "at the expense of Gloucester shareholders' right to consider a proposal that affects control of their company" and should be subject to shareholder approval (at [25]).

The Review Panel, relying on a different set of factual circumstances, formed the view that Gloucester's offer would result in a substantially different shareholder composition post-merger to that envisaged by the Initial Panel.<sup>23</sup> In particular, it considered that neither the significant dilution of Gloucester's shareholding or the potential existence of two entities with shareholdings in excess of

<sup>18</sup> The orders provided that Gloucester's bid for Whitehaven be subject to a condition that "no superior proposal for Gloucester is made or announced". The terms of the condition stipulated that a proposal was superior if (a) the independent directors of Gloucester formed the opinion, reasonably, in good faith and for a proper purpose based on their fiduciary duties, that it is more in the interests of Gloucester's shareholders than Gloucester's bid for Whitehaven; and (b) it is conditional on Gloucester's bid for Whitehaven not proceeding or otherwise lapsing or being withdrawn.

<sup>19</sup> It is worth noting that the Whitehaven merger, and the subsequent events referred to in this, occurred against the backdrop of unprecedented rises in the prices for thermal and coking coal. These price rises were reflected in the implied value of Gloucester's scrip. Gloucester Coal Ltd, "Update on Takeovers Panel Decision", *ASX Market Release* (29 April 2009), <http://www.asx.com.au/asxpdf/20090429/pdf/31h9pwwz88jtqh.pdf> viewed 15 November 2009.

<sup>20</sup> Noble Group Ltd, "Noble Group Increases Its Cash Offer for Gloucester Coal to \$6.00 per Share", *Media Release* (5 May 2009), <http://www.asx.com.au/asxpdf/20090505/pdf/31hf82c2rt9jpd.pdf> viewed 15 November 2009.

<sup>21</sup> Whitehaven Coal Ltd, "Application by Noble Group to the High Court", *ASX Market Release* (13 May 2009), <http://www.asx.com.au/asxpdf/20090513/pdf/31hkk6yd3zfxh.pdf> viewed 15 November 2009. That application was remitted to the Federal Court of Australia on Noble's application.

<sup>22</sup> See n 16.

<sup>23</sup> See n 17. See also *Gloucester Coal Ltd 01* [2009] ATP 6 where the Initial Panel observed at [12]: "There is disagreement as to the relevant interests of directors and their associates. We did not feel we needed to examine this." It is interesting that the Initial Panel chose not to explore the disputed facts in greater detail given their relevance, as evidenced in the Review Panel's decision, to the ultimate determination of the proposed transaction's effect on control. The approach of the Initial Panel indicates that it will presume that information released to the public by a company is correct. See further *Gloucester Coal Ltd 01* [2009] ATP 6 at [18].

20% (provided they were unassociated)<sup>24</sup> would result in a change or effect on control of a sufficient “nature and scale” to require Gloucester shareholder approval (at [24]-[25]).

The Review Panel took the view that a shareholding exceeding the 20% acquisitions threshold would not necessarily need to be put to shareholders (at [28]). This contrasted with ASIC’s submission that the acquisition of a 20% interest “provided a good guide as to when control of a company had passed” (at [27]). The Review Panel was of the opinion that ASIC did not intend that every acquisition above 20% required shareholder approval because “s 611 item 4 reflects a policy that there may be an acquisition of a relevant interest above 20% as a result of the acceptance of a takeover”, and to provide otherwise would undermine the exception (at [28]).<sup>25</sup> The decision affirms that control transactions should be decided by shareholders of the relevant company, but only where the proposed transaction would have an effect on control of a sufficient “nature and scale” (at [24]-[25]).

An unfortunate consequence of the Review Panel’s reasoning is that, in circumstances where a reverse takeover does not produce a dominant shareholder in the merged entity, it will be difficult for takeover proponents to gauge whether or not shareholder approval is required.<sup>26</sup> The decision also leaves it open for company boards to bypass shareholder approval on the basis that the proposed transaction will not amount to a change of control in the bidding entity. While disenfranchised shareholders could challenge board action of this nature on the basis that shareholders’ right to decide control of the company has been denied to them, in this author’s opinion the onus should be the reverse. The author proposes that, for reverse takeover transactions which result in the acquisition of a relevant interest of 20% or greater, there should be a presumption that shareholder approval is required. On application, ASIC or the Takeovers Panel could give approval for the transaction to proceed without shareholder approval where it was satisfied that the transaction would not result in an unacceptable effect on control. This regime would facilitate the protection of rights of shareholders to decide control transactions in the reverse takeover context.

### Imposing fiduciary outs

Interestingly, the Review Panel based its declaration of unacceptable circumstances on the Takeovers Panel’s lock-up devices policy in Guidance Note 7.<sup>27</sup> The Review Panel formed the view that various elements of the Whitehaven merger amounted to a lock-up device. Of particular concern was the inclusion of an agreed bid announcement in the MIA, the terms of which did not include a fiduciary out for the Gloucester board to consider superior proposals for Gloucester (at [47]-[51]). Consequently, once the bid announcement had been made, Gloucester would be bound by s 631 to proceed with the bid on the same terms as those announced or terms not substantially less favourable (at [50]-[51]).

The Panel considered the restrictive arrangement to be “in substance although not form” inconsistent with the Panel’s policy (at [51]), which, at the time of the decision, stated:

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<sup>24</sup> In the absence of association, the Review Panel stated in *Gloucester Coal Ltd 01* [2009] ATP 9 at [41]: “If we cannot establish an association, we must remain open to the possibility that in fact the separate holdings will act as countervailing interests rather than as a block.”

<sup>25</sup> Importantly, the Review Panel acknowledged (at [30]) that there may be circumstances where the acquisition of a shareholding of just over 20% constituted a change of control. In addition, the Panel indicated that, had the two largest shareholders been associated and their respective stakes aggregated to 42%, shareholder approval would have been required.

<sup>26</sup> The Takeovers Panel has recognised this issue and has recently sought comments on it. In the draft rewrite of Guidance Note 1, the Takeovers Panel has asked for submissions to address, among other things, whether it should provide guidance as to what may constitute a change of control in these circumstances and whether triggering that definition should result in the requirement for a shareholder vote: see Takeovers Panel, n 6.

<sup>27</sup> That policy provides that the term “lock-up device” refers to “an arrangement that encourages or facilitates a control transaction and potentially hinders another actual or potential control transaction.” See Takeovers Panel, *Guidance Note 7: Lock-Up Devices* (11 February 2010), [http://www.takeovers.gov.au/content/Guidance\\_Notes/Current/downloads/GN07\\_2010.pdf](http://www.takeovers.gov.au/content/Guidance_Notes/Current/downloads/GN07_2010.pdf) viewed 14 May 2010.

The Panel regards it as essential that a no-talk agreement contain an appropriate “fiduciary exception”, allowing directors to respond positively to any better proposal if they form the view that to do so would be in the best interests of target shareholders.<sup>28</sup>

The correctness of the Review Panel’s reliance on the lock-up devices policy has been questioned.<sup>29</sup> In particular, there is some uncertainty whether, in light of the Panel’s conclusions that a change of control in Gloucester had not occurred, the circumstances of the Whitehaven merger actually justified the imposition of the fiduciary out which would effectively allow the bidder (Gloucester in this case) to avoid the requirement in s 631 where a superior proposal emerged. As Riley-Smith observes:

It is not clear from the Panel’s reasons how, in the absence of a change of control of Gloucester, the bid for Whitehaven can be distinguished for any other company that makes a takeover bid – isn’t it the case that whenever a company makes a takeover bid, the opportunity for another company to bid for the bidder on a stand alone basis is lost?<sup>30</sup>

It is evident from the Panel’s decision that inclusion of a bidder’s fiduciary out in the reverse takeover context can be necessary even where a change of control has not occurred. Given that every bid limits the ability of the bidder to consider alternative proposals for itself due to the operation of s 631, the Panel was not explicit about why precisely it thought that such conditions will be “more likely to be appropriate for a reverse takeover than an ordinary takeover” (at [62]). The most likely conclusion is that the distinction is based on the Panel’s view of the Whitehaven merger as a dual-target merger or, in the Panel’s words, “a merger where both parties are in play” (at [44]-[45]).<sup>31</sup>

However, the Review Panel was keen to point out that it was not laying down a general principle that a fiduciary out for the bidder to consider superior proposals was a necessary condition in all reverse takeovers (at [62]). Indeed, the Review Panel considered that Gloucester’s bid had “unique features” which meant that the absence of an effective fiduciary out condition gave rise to unacceptable circumstances (at [62]). Exactly what amounted to the unique features of the Whitehaven merger is not entirely clear as the Review Panel did not specify the features of the merger it considered relevant.

Ryan has suggested that the unique features referred to by the Panel may have been Noble’s non-passive blocking interest on Gloucester’s shareholder register.<sup>32</sup> He states that, “If Noble’s presence on the register made a difference, perhaps it is because Gloucester directors should have been on notice that a bid was possible”.<sup>33</sup> This is certainly the most likely grounds for the distinction between the Whitehaven merger and other reverse takeovers. Yet, if the Review Panel’s concern is

<sup>28</sup> Takeovers Panel, *Guidance Note 7: Lock-Up Devices* (11 November 2007), [http://www.takeovers.gov.au/content/Guidance\\_Notes/Current/downloads/GN07\\_2007.pdf](http://www.takeovers.gov.au/content/Guidance_Notes/Current/downloads/GN07_2007.pdf) viewed 14 May 2010. The most recent publication of Guidance Note 7 contains words to similar effect: “In the absence of an effective ‘fiduciary’ out, a no-talk restriction is likely to give rise to unacceptable circumstances.” See Takeovers Panel, n 27 at [27].

<sup>29</sup> See Riley-Smith J, “Reverse Takeovers – Where to From Here? Gloucester Coal Review Panel Decision”, *Corrs Chambers Westgarth M&A Newsletter* (June 2009), <http://www.corrs.com.au> viewed 15 November 2009; Ryan D, “Reversal of Fortunes”, *Blake Dawson Takeovers Legal Update* (21 May 2009), <http://www.blakedawson.com> viewed 15 November 2009.

<sup>30</sup> Riley-Smith, n 29, p 3.

<sup>31</sup> The Panel characterised the merger as such on the basis of the following: the structure offered deal certainty by side-stepping Noble’s blocking stake; it was an agreed deal; the structure meant that Whitehaven shareholders would obtain CGT rollover relief and other accounting treatment advantages; and the market capitalisation of Whitehaven was approximately 2.3 times that of Gloucester.

<sup>32</sup> Ryan, n 29, p 5. While Ryan did not describe the events that would suggest that Noble’s interest on Gloucester’s register was non-passive, the following conduct on the part of Noble supports this view. On 26 June 2007, Noble significantly increased its stake in Gloucester to 10.4% to thwart a proposed takeover of Gloucester by Xstrata. Subsequently, Gloucester continued to increase its stake to the 21.67% it held at the time the Whitehaven merger was announced. In Noble’s bidder’s statement released to Gloucester shareholders on 15 May 2009, Noble indicated that if it did not acquire effective control of Gloucester as a result of its offer, it may make further acquisitions of Gloucester shares via the creep provisions under item 9 of s 611: Noble Group Ltd, *Bidder’s Statement* (15 May 2009) p 20 at [5.5], <http://www.asx.com.au/asxpdf/20090520/pdf/31hpgzx0lb8r5x.pdf> viewed 15 November 2009. See also Maiden M, “Gloucester Banking on Whitehaven”, *The Age* (7 May 2009), <http://www.thisisnoble.com> viewed 15 November 2009.

<sup>33</sup> Ryan, n 29, p 5.

with bidder shareholders being prevented from access to the benefits of a superior proposal, it is difficult to envisage why such a condition should not be required for all reverse takeover transactions, at least where both parties are “in play” (ie where both entities are listed and have open registers without the presence of blockholders). In this author’s opinion, requiring a fiduciary out in those circumstances would remove a lot of the uncertainty surrounding the Review Panel’s decision about when it is appropriate to include a fiduciary out condition in a bid.

### **The legality of superior proposal conditions**

The Review Panel’s decision is also contentious as it arguably extends the role of directors in contests for control at the expense of shareholder rights.<sup>34</sup>

Noble submitted that the orders of the Panel did not adequately protect the rights and interests of Gloucester shareholders, but (at [70])

hand control of the decision as to whether Gloucester shareholders should have the opportunity to consider the Noble Bid or any other bid to the Gloucester directors, the very people who structured the Gloucester Bid such that it improperly prevented an auction for control of Gloucester in the first place.

The Review Panel did not agree with this submission, and considered that providing Gloucester directors with the opportunity to consider alternative proposals protected the rights and interests of shareholders by allowing them to participate in any benefits accruing from another proposal (at [71]). In addition, the Panel stated that there was nothing to suggest that the independent directors of Gloucester “[would] act otherwise than properly in the performance of their fiduciary duties” (at [73]).

By its terms, the condition imposed is subjective, being satisfied only where the Gloucester directors “form the opinion ... that it is more in the interests of Gloucester’s shareholders” (at [73]). Thus, the condition confers broad discretion on Gloucester’s directors to disregard an alternative proposal regardless of the respective value that the proposal may offer to shareholders. Equally, the potential for conflict is heightened as directors may be drawn to pursue proposals that will better serve their interests. The Review Panel’s decision is favourable to those companies wishing to side-step blocking shareholders, in that it effectively allows Gloucester directors to proceed with their preferred proposal unimpeded.<sup>35</sup>

However, it is unclear whether a superior proposal condition framed in comparable terms to that prescribed by the Panel could be included in future reverse takeovers, given that it may contravene s 629(1).<sup>36</sup>

This issue was addressed by the Review Panel in its reasons, stating (at [75]):

We are of the view that, in these circumstances, the insertion of a condition into the bid to give effect to a fiduciary out in the MIA does not cause Gloucester to breach section 629. Similar to the assessment of a material adverse change, the assessment of a superior proposal is not solely within the opinion, belief, state of mind or control of the bidder.

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<sup>34</sup> See MacIntyre L, “Gloucester-Noble Courts Reverse Takeover Controversy”, *Lawyers Weekly* No 440 (12 June 2009) p 9, citing comments of John Elliot, Karen Evans-Cullen and Tony Damian. Philips has recently observed that the Panel’s decision in *Gloucester Coal* (and *International All Sports Ltd OIR* [2009] ATP 5 in respect of standstill arrangements) has “affirmed the role of directors as gatekeepers of public bids” in prescribed circumstances: Philips J, “Target Directors and Competition for Control: Keeping the Gate, or the Drawbridge?” in “Takeovers and Public Securities” (2009) 27 C&SLJ 545 at 549.

<sup>35</sup> In relation to the discretion conferred on directors, Philips, n 34 at 554, has rightly noted that this “heightens the importance of an appropriate standard against which to assess board conduct”.

<sup>36</sup> That provision provides that offers under an off-market bid must not be subject to a defeating condition if the fulfilment of the condition depends on the bidder’s or an associate’s opinion, belief or state of mind, or the happening of an event within the control of the bidder or an associate.

The analogy drawn by the Review Panel to material adverse change conditions is misleading. A material adverse change condition does not inherently avoid contravention of s 629.<sup>37</sup> Like all other defeating conditions, infringement will ultimately depend on the wording of the condition.<sup>38</sup>

In the author's opinion, the Review Panel should have given greater consideration to the illegality issue raised by the subjective nature of the no superior proposal condition. The fact that Panel orders can require a person to do something contrary to a provision of Ch 6 is relevant.<sup>39</sup> Nevertheless, as ASIC submitted, the Panel needed to weigh the "possible benefits of the condition against the uncertainty created by imposing a condition that turns on the bidder's opinion and the fact the proposed condition arguably raises concerns of the type that section 629 seeks to address" (at [76]).

It stands to reason that if conditions such as these are to be included in future transactions they should be framed in more objective terms.<sup>40</sup> One option would be to place the determination of a superior proposal (ie the respective value to the bidder of competing bids) in the hands of an independent expert, or make the directors' opinion subject to review by an independent expert. The latter approach is preferable in that it does not wholly abrogate the directors' decision – whether or not to pursue a particular transaction – to an independent expert. There is also the question of the extent to which an independent expert can appropriately account for non-pricing factors, such as the level of conditionality attaching to the offer and the form of the consideration.<sup>41</sup> Nevertheless, a condition which required that a board's decision be referable to an independent expert's assessment would be less likely to contravene s 629, while providing greater comfort to bidder shareholders that the competing proposals for the company were being assessed on their respective merits.

## CONCLUSION

The outcome of the Panel's intervention was a very positive result for Gloucester shareholders. The superior proposal condition enabled Noble to participate in the contest for control, resulting in a substantial control premium for Gloucester shareholders. Unfortunately, however, *Gloucester Coal* is not the comprehensive statement of principle in respect of reverse takeovers that many had hoped for. In the interests of certainty, the Panel should more clearly define when a reverse takeover will have an effect on control such that shareholder approval is required. In addition, in circumstances where both the bidder and the target in a reverse takeover can be regarded as being "in play", a fiduciary out allowing both parties to consider superior proposals should be a requirement. This will go some way to ensuring that shareholders of the bidding entity are not excluded from receiving the benefit of

<sup>37</sup> See *Dolomatrix International Ltd* [2008] ATP 10 where a no material adverse change condition included in the bidder's statement was deemed to have been contravened if the target company had materially breached its continuous disclosure requirements under the ASX listing rules and, if the bidder had known this, it would have had a material adverse effect on the price the bidder would have offered under the takeover bid. The condition was found to contravene s 629 as the bidder could have of its own accord decided that a significantly lower price would have been offered.

<sup>38</sup> See *Dolomatrix International Ltd* [2008] ATP 10 at [13] where the Panel emphasised the need for criteria triggering defeating conditions to be expressed in precise term so that construction of the condition was not within the control or subjective judgment of the bidder. The Panel stated: "[I]t is important that conditions are sufficiently definite so that a target and its shareholders can assess the risk that they will not be satisfied."

<sup>39</sup> See Guidance Note 4 at [14] and s 657D(2).

<sup>40</sup> The Takeovers Panel has recently acknowledged, in its draft rewrite of Guidance Note 1, that a "superior proposal" condition "should be drafted in objective terms". Takeovers Panel, n 6.

<sup>41</sup> In relation to the valuation issue arising from the form of the consideration, see Philips, n 34 at 553, where the author illustrated the potential difficulties: "With a cash counterbid, the most difficult aspect of conducting this analysis would presumably be assessing the (uncertain) value to shareholders of staying in the company after completion of the reverse bid against the certain value of the cash counterbid. With a scrip counterbid, the comparison would be of the (uncertain) value of the company's scrip, post reverse bid, with the (also uncertain) value of the counterbidder's scrip, post counterbid."

alternative proposals for the company. Further guidance from the Takeovers Panel in respect of these issues will clarify its position and greatly assist future deal structuring and transaction certainty.

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*The author thanks Dr Paul Ali, The University of Melbourne, for his invaluable guidance and advice on this note. The author also thanks the anonymous referee and gratefully acknowledges the assistance of the Australian Research Council (DP0557673). The views expressed in this note are the author's and not necessarily those of Arnold Bloch Leibler.*