



## GUIDANCE NOTE 19: Insider Participation in Control Transactions

Issued for comment 21/02/2007

### Overview

1. This Guidance Note provides takeover market participants with guidance on situations where there is involvement or potential involvement by the management, directors or external advisers of a target company<sup>1</sup> with the bidder<sup>2</sup> (**insiders** or **participating insiders** (see paragraphs 9 to 11 below)) in a takeover bid or potential bid for the target company (**bid**)<sup>3</sup>.
2. The Panel's primary concerns in those situations are to ensure that:
  - (a) consideration by the target board and management of the bid, and any competing proposal, is undertaken free from any actual influence, or appearance of influence, from participating insiders; and
  - (b) any disclosure of target company confidential information to the bidder or potential bidder is subject to appropriate controls.
3. This Guidance Note sets out when the Panel may declare circumstances arising from such situations to be unacceptable having regard to the purposes of Chapter 6 of the *Corporations Act* 2001 (**Act**), set out in section 602 of the Act.

#### *Panel's jurisdiction - directors' duties etc*

4. There is considerable overlap of the issues which are discussed in this Guidance Note with directors' and employees' duties, employment law and the duties and terms of engagement of advisers. This guidance applies to these issues where they affect the principles set out in section 602 of the Act, including the maintenance of an efficient, competitive and informed market for a company's securities where the company is subject to a takeover bid.
5. 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 the takeover bid, not to determine whether there has been a breach of directors' or employees' duties or other aspects of law. The Panel does not regard it as being its role to determine and enforce such duties and obligations.

#### *Private Equity and other buy-outs*

6. The issues discussed in this Guidance Note are not particularly new, and are applicable to all takeover bids (irrespective of the source of funding). However,

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<sup>1</sup> "Companies" include listed managed investment schemes and listed bodies.

<sup>2</sup> Bidder includes the bidder and its associates.

<sup>3</sup> In this Guidance Note, the term "bid" may include takeover bids, schemes of arrangements and other control transactions. The Panel recognises that the courts regulate schemes of arrangement. However, the issues discussed in this Guidance Note may arise in circumstances where the issues are not supervised by the court.

some of the issues have recently been brought to current prominence by the increase in the number of private equity bids or other buy-outs which frequently have features which make this Guidance Note particularly relevant for such bids.

7. The Panel recognises that private equity bids or other buy-outs can have a significant effect on markets and that the decisions as to the ownership of companies lie with properly informed target company shareholders.
8. The Panel is concerned not to discriminate between private equity bidders and other types of bidders in its application of the takeovers provisions, where different treatment is not appropriate or warranted by policy reasons.

### Participating Insiders

9. For the purposes of this Guidance Note, the term “**insider**” is intended to include persons with significant inside or non-public information concerning the target company, gained by virtue of a position of trust with the company, or who hold a position of trust, for example:
  - (a) senior management;
  - (b) directors; and
  - (c) financial and other advisers of the company.
10. The term “**participating insider**” is intended to include insiders who are given an understanding by, or enter or propose to enter into an agreement with, a potential bidder that they will gain or benefit<sup>4</sup> from the bidder making a successful bid, for example, by:
  - (a) acquiring equity in, or options or other derivatives over such equity in:
    - (i) the target;
    - (ii) the bid vehicle or a related entity;
    - (iii) the bidder or a related entity;
    - (iv) another entity whose performance is related to the performance of the target; or
    - (v) funds managed by the bidder or related entities; or
  - (b) acquiring derivative financial instruments or financial incentives which would mimic the performance of any of the above; or
  - (c) agreeing to enter into, or forming an understanding about entering into, employment or other agreements that will apply if the target is acquired by the bidder and are reasonably likely to cause a real or perceived conflict of interest for the insider because of their value, for example significant levels of compensation, or cash or fee incentives, based on the

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<sup>4</sup> Including obtaining a “financial benefit”.

performance of the target or elements of the target.<sup>5</sup>

11. The Panel intends that the description of participation should not include:
  - (a) an offer by a potential bidder to continue the person's existing equity, compensation or other arrangements with the target or enter into new arrangements on similar terms to the existing arrangements<sup>6</sup>; or
  - (b) fees or other arrangements entered into between the target and an adviser under which the adviser would gain or benefit from the bidder making a successful bid.

### Addressing Potential Conflicts of Interests

12. The Panel considers that insiders should inform the board:
  - (a) as soon as they are approached by a potential bidder; and
  - (b) before they take any actions, including the provision of any "non-public" information concerning the target company or commence any discussions to formulate any strategy to acquire the target company or approach a potential bidder.
13. Insiders should seek the board's consent before they take any action, enter into any discussions or provide any information in relation to any possible bid.
14. The Panel considers that companies should make such requirements clear to their management and boards, and that bidders seeking to gain the support of insiders should also make any proposed discussions subject to such requirements.
15. As soon as the board of a company becomes aware or informed of a bid or potential bid for the company, in which there is, or is likely to be, participation by insiders, it should establish appropriate protocols which allow the board to assume control of the takeover process. Normally this will involve appointing an independent board committee (**IBC**) consisting of non-participating directors<sup>7</sup> to oversee the application of these protocols and the process in the interests of target shareholders. Any directors who are participating insiders should not be present at, or participate in or vote on, any consideration by the board of the bid or any competing bid.
16. When considering what processes and protocols to adopt to manage the bidding and negotiation process and potential conflicts of interests of participating insiders, the IBC should have regard to the effect that any such processes and protocols could have on the interests of shareholders in order to

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<sup>5</sup> The Panel would be concerned if the spirit and intention of this Guidance Note were sought to be avoided by the timing of any understanding or agreement, or by making any agreement or understanding tacit.

<sup>6</sup> The Panel would not consider new arrangements to be equivalent to the continuation of existing arrangements if the management receive cash or other benefits on termination of the existing arrangements i.e. new arrangements would not be viewed as "rolled over" if the management cash-out the old arrangements prior to entering the new ones with the bidder.

<sup>7</sup> This will usually consist of non-executive/independent directors.

ensure that the principles set out in section 602 of the Act are upheld. These include ensuring that:

- (a) the acquisition of control over voting shares of listed companies takes place in an efficient, competitive and informed market; and
- (b) the holders of shares in a company:
  - (i) know the identity of the person who proposes to acquire a substantial interest in the company;
  - (ii) have reasonable time to consider the proposal; and
  - (iii) have enough information to assess the merits of the proposal.

17. The protocols should seek to:

- (a) establish rules concerning information disclosure and access, confidentiality and related matters;
- (b) preclude influence by participating insiders on the target's response to any proposal (recognising that the IBC may need to obtain information from participating insiders, including to assist with the preparation of the target's statement and to comply with section 638 of the Act) (see also paragraph 18(b) below);
- (c) ensure that the IBC has appropriate advice; and
- (d) ensure that shareholders' best interests are advanced in the face of any proposal involving participating insiders, including through the IBC's approach or attitude to potential rival bidders and the proper ongoing conduct of the company's business during the period.

18. The Panel does not wish to prescribe what processes or protocols an IBC should adopt to manage potential conflicts of interests of participating insiders in order to ensure that the principles in section 602 of the Act are upheld. However, as an illustrative example, the Panel sets out some protocols that an IBC may adopt, where appropriate to a company's circumstances. Each IBC will need to consider and adopt protocols appropriate to its company's circumstances. Where an IBC chooses not to adopt some or all of the protocols set out below, the Panel would normally expect that any other protocols adopted would be no less effective in ensuring an efficient, competitive and informed market for the target company's securities. Examples of protocols that an IBC may consider adopting include:

- (a) informing participating insiders and bidders that the IBC will control any process and the degree of any involvement by participating insiders. To assist compliance with this, the IBC may require a representative of the target company to be present at all meetings between participating insiders and the bidder or potential bidder;
- (b) requiring participating insiders to:
  - (i) cease communications or involvement with any bidder or potential bidder, except as permitted under the protocols established by the IBC; or

- (ii) stand aside or resign from their management/board positions in order to pursue the proposed bid (recognising that certain legal and equitable obligations, including with respect to confidentiality and use of information may continue notwithstanding such resignation and subject to the Board's ongoing right to require assistance from those insiders during that leave of absence);
  - (c) advising participating insiders that they must not provide any corporate information<sup>8</sup> to anyone<sup>9</sup> without the express approval of the IBC and following entry into an appropriate confidentiality agreement between the target company (represented by the IBC) and the person;
  - (d) requiring that none of the participating insiders discuss the bid or any competing proposal with customers, suppliers or other employees of the target company unless specifically requested to do so by the IBC, and only on terms and conditions approved by the IBC; and
  - (e) requiring participating insiders to confirm to the target company that they have not previously disclosed "non public" information about the target company to the bidder or potential bidder with whom they are involved.
19. In addition, the Panel would normally expect that an IBC would adopt processes and protocols to monitor, manage and control the flow of information to all actual and potential bidders, including those that are involved with participating insiders.
20. The Panel is more likely to find that unacceptable circumstances exist where appropriate protocols have not been established and followed to ensure that:
- (a) potential conflicts of interest are adequately addressed; and
  - (b) an efficient, competitive and informed market for control of securities of the company, and the principles set out in section 602, are upheld.

### Provision of Information to Potential Rival Bidders

21. The Panel would normally expect that, in circumstances where target directors have not provided equal access to information to potential rival bidders, they would have sound reasons for their decision<sup>10</sup>, given the effect or potential effect of their decision on an efficient competitive and informed market for the target company and its securities that a selective release of such information to some (but not all potential bidders) by the target company may cause<sup>11</sup>.
22. If participating insiders are involved in a takeover bid or potential takeover bid, and other potential bidders are given less information than that given to the bid involving participating insiders, the Panel, if it receives an application, would likely scrutinise very closely the circumstances, and reasons given by target

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<sup>8</sup> including the existence of any potential bidder or the details of any potential bid.

<sup>9</sup> including any employee, customer or supplier of the target.

<sup>10</sup> Goodman Fielder 02 [2003] ATP 5 at [96].

<sup>11</sup> An effect on the efficient, competitive and informed market for securities of the company will, necessarily, have some effect on the interests of shareholders of the company.

directors in support of their decision to withhold that same information from the other potential bidders (and especially where the bid involving participating insiders is recommended by the target board). This is to ensure that the reasons and the outcome are consistent with the purposes of Chapter 6, and in particular, with the existence of an efficient, competitive and informed market for the securities in the company.

### Disclosure to Shareholders

23. The IBC should carefully consider all information provided to any potential bidder to determine whether section 638 requires that such information be included in the target's statement. The Panel considers that, as a general principle, the target should seek to ensure that a bidder who is involved with participating insiders does not have an information advantage over shareholders<sup>12</sup>. For example, a target should carefully compare the level and detail of information which was provided to the bidder against the level of information disclosed in the target's statement.
24. Similar requirements clearly also apply to a bidder who receives information from the target or from participating insiders. A bidder should consider the information to be disclosed in its bidder's statement very carefully. For example, a bidder should carefully compare the level and detail of information which was provided to the financiers to the bid against the level of information disclosed in the bidder's statement.
25. The bidder and the IBC should ensure that there is adequate disclosure to target shareholders, whether in the bidder's statement or target's statement, including information as to:
  - (a) the identity of any participating insiders;
  - (b) details of any incentive, participation and fees offered to participating insiders;
  - (c) the process, and the protocols adopted by the IBC to address potential conflicts of interest; and
  - (d) the identity of the persons behind a bidder to the extent required by sections 602, 636(1)(a) or, if cash consideration is offered and funds are to be provided by entities behind the private equity or other buy-out "fund", section 636(1)(f)(ii) (this may be particularly relevant in the case of private equity bids or other buy-outs where the identity of persons behind the bid vehicle may not easily be publicly available).
26. The Panel is more likely to find that unacceptable circumstances exist where target shareholders have not been given adequate information or where a bidder that is involved with participating insiders has an information advantage over shareholders, because of the information that it has received from the target company or from participating insiders.

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<sup>12</sup> Such information advantage may include forward looking information.