Current Issues in Takeovers Regulation

Tuesday 11 August 2015
Presented by Allan Bulman and Alan Shaw, Michelle Jablko and Rodd Levy
Current issues in takeovers regulation
11 August 2015

Allan Bulman
Director

Alan Shaw
Counsel
Part 1
Purpose
Purpose of our presentation

Panel background

Results of Panel survey

Current issues for the Panel

• Consultation on Shareholder intention statements

• GN 14 clarification following ASIC v Mariner Corporation
Part 2
Panel background
Panel organisation

Counsel
Alan Shaw

Director
Allan Bulman

Manager
Karolina Ksiezak

Assistant
Rebecca Andrewartha

Change every 8 months

Secondee
Nayanisha Samarakoon

Secondee
Viet Nguyen
Current Panel membership

Profession:
- Banker: 13
- Corporate: 11
- Lawyer: 19

Gender:
- Male: 26
- Female: 17

Location:
- Sydney: 21
- Melbourne: 13
- Perth: 5
- Adelaide: 2
- Brisbane: 1
- New Zealand: 1
Part 2
Panel survey
## Panel surveys

<table>
<thead>
<tr>
<th>Study</th>
<th>Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chant Link (2006)</td>
<td>In depth interviews of 37 respondents</td>
</tr>
<tr>
<td>Law Council (2010)</td>
<td>Web based survey of 150 respondents</td>
</tr>
<tr>
<td></td>
<td>Legal practitioners and company directors who had dealt with the Panel in last 5 years, investment bankers, Panel members, Panel alumni and ASIC/ASX</td>
</tr>
</tbody>
</table>
Overall satisfaction score – all areas

Mean overall Satisfaction rating 7.7

- Dissatisfied (0-4): 8%
- Neither (5): 3%
- Satisfied (6-7): 19%
- Very satisfied (8-10): 69%

89% Satisfied*

Panel process: 7.4 / 10 (15% Impact)
Panel performance: 7.9 / 10 (13% Impact)
Sitting Panel composition: 7.2 / 10 (1% Impact)
Panel executive: 7.7 / 10 (8% Impact)
Outcomes of proceedings: 7.2 / 10
Operational delivery: 7.5 / 10 (17% Impact)

* All results exclude Panel members
Possible areas of focus – decision making and reasons

Handling novel issues
75% satisfied

Market guidance
76% satisfied

Weight to “Black Letter” law
77% satisfied

What level of legal analysis in its reasons do you believe the Panel provides?

- Not enough attention (0-2) - 5%
- Moderately not enough (3-4) - 28%
- Neither (5) - 45%
- Moderately too much (6-7) - 16%
- Too much attention (8-10) - 6%
Possible areas of focus - conducting proceedings

Conducting proceedings
79% satisfied

The Panel conducts proceedings

Application outcomes

- Decline to conduct
- Conduct proceedings, no declaration
- Declaration and orders
- Declaration - other*
- Withdrawn

*Other = Declaration (no orders), Declaration with undertaking
Possible areas of focus - association

Association cases
70% satisfied

Outcome of association applications

- Conduct no declaration, undertaking
- Conduct no declaration
- Withdrawn
- Declaration and orders
- Decline to conduct
- Decline to conduct, undertaking
Other findings

95%  Considered the media canvassing ban should continue

61%  Felt the Panel paid the right amount of attention to ASIC’s views
      (35% felt too much, 4% not enough)

82%  Preferred to seek resolution by the Panel where the Panel’s jurisdiction is shared with the Courts

75%  Would prefer not to go to Court in the part of the Panel’s jurisdiction where the Courts are excluded
Part 3
Current issues for the Panel
Issues for the Panel

1. Shareholder intention statements - to discuss
2. Bid funding and the ASIC v Mariner decision - to discuss
3. Rights issues - particularly ‘loan to own’
4. Tracing beneficial ownership - possible law reform
5. Shareholder activism - a watching brief
Shareholder intention statements (1)

Two cases in 2014:

Rejection:
Stated 41.8% intended not to accept.

Acceptance:
Stated 6.6% intended to accept.
Shareholder intention statements (2)

Acceptance:
25% stated intention to accept

19.9% pre-bid stake (after 25%)

Rival bids

Drillsearch

Magnum Hunter Resources Corporation

AG

Ambassador Oil and Gas
Why is the Panel interested?

1. RG 25 includes major shareholders

2. Intention statements may help get a bid - the Panel does not encourage or discourage shareholder intention statements

BUT -

1. Relevant interests can be created?

2. Statements can be misleading or confusing
Draft Guidance Note

Consultation Paper issued 7 July 2015

Comments sought by 1 September 2015

Copy: www.takeovers.gov.au
<table>
<thead>
<tr>
<th>Topic</th>
<th>GN response</th>
<th>Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevant interest</td>
<td>Notes risk</td>
<td>Give more guidance as to when a relevant interest arises?</td>
</tr>
<tr>
<td>Qualifications</td>
<td>• If &gt; 20%, may be unacceptable without ‘no superior proposal’&lt;br&gt;• If ‘no superior proposal’, a reasonable time should pass before acceptance</td>
<td>Specify a time - 14 days, 21 days, other?</td>
</tr>
<tr>
<td>Consents</td>
<td>Only publish if consent Aggregated statements need consent if material.</td>
<td>Should consents always be obtained?</td>
</tr>
</tbody>
</table>
Bid funding

Corporations Act s631(2)(b):

A person ... must not publicly propose to make a bid if the person is reckless as to whether they will be able to perform their obligations relating to the takeover bid if a substantial proportion of the offers under the bid are accepted

ASIC Regulatory Guide 59 - based on former s746

Guidance Note 14:

• A bidder must have funding, or a reasonable expectation of funding, to pay for all acceptances

Austock Group Limited [2012] ATP 12
ASIC v Mariner Corp

ASIC v Mariner Corporation Limited [2015] FCA 589

Held:
1. Law changed from ‘reasonable basis’ to ‘reckless’

2. The test for ‘reckless’ is subjective

3. Proof needed of 2 things -
   1. actual awareness of a substantial risk that it would not be able to perform its obligations if a substantial proportion of offers under the bid were accepted and
   2. it was unjustifiable to take that risk, having regard to the circumstances known to it.
Implications

Potential for false market

Consequences of funding failure

International difference

Amend GN 14 to make it clear it is based on s602?

The general purpose in s602(a) could be facilitated on either construction of s631: ASIC v Mariner at [266]
The Facts are Well Known

- Size no longer matters
- All industries are susceptible
- Number of campaigns continues to grow

**Market cap**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Company Names</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>BNY Mellon, MSCI, Lazard, UBS</td>
</tr>
<tr>
<td>Technology / Telecom</td>
<td>Qualcomm, ISSI, eBay, Juniper, TDS Telephone and Data Systems</td>
</tr>
<tr>
<td>Consumer / Retail</td>
<td>Tempur Sealy, AN Inc., Dillard’s, Sotheby’s</td>
</tr>
<tr>
<td>Healthcare</td>
<td>Forest Laboratories, Allergan, CorMedix, Zoetis</td>
</tr>
<tr>
<td>Industrial</td>
<td>DuPont, Graftech International, Meritor, Lear Corporation</td>
</tr>
<tr>
<td>Energy</td>
<td>Endeavour, Chesapeake, Marathon Petroleum Corporation, Noble</td>
</tr>
<tr>
<td>Basic Materials</td>
<td>Cliffs, Wausaupaper, Tronox</td>
</tr>
<tr>
<td>Real Estate / Gaming</td>
<td>Associated Estates, Pinnacle Entertainment, Affinity Gaming</td>
</tr>
</tbody>
</table>

**Source:** Capital IQ, Factset, Shark Repellent

**Note:**
1. Equity market capitalisation at the time of activist campaign
Perspectives on the Rise of Shareholder Activism

Record Levels of Liquidity and Influx of Funds Perpetuating the Cycle

Aggregate Cash Balance of S&P 500 Companies (ex. Financials)¹ – US$t

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>1.0</td>
<td>1.1</td>
<td>1.2</td>
<td>1.3</td>
<td>1.5</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Activist Fund Capacity (@2x Leverage) – US$b

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Icahn</td>
<td>102.6</td>
<td>142.2</td>
<td>157.5</td>
<td>196.5</td>
<td>279.3</td>
<td>358.2</td>
</tr>
</tbody>
</table>

Increasing Number of Activists – Large and Small – US$b Fund Size²

<table>
<thead>
<tr>
<th>Activist</th>
<th>Fund Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Icahn</td>
<td>31.9</td>
</tr>
<tr>
<td>Pershing</td>
<td>16</td>
</tr>
<tr>
<td>ValueAct</td>
<td>16</td>
</tr>
<tr>
<td>JANA</td>
<td>11.5</td>
</tr>
<tr>
<td>Third Point</td>
<td>11.1</td>
</tr>
<tr>
<td>Elliot</td>
<td>9.6</td>
</tr>
<tr>
<td>Train</td>
<td>9.4</td>
</tr>
<tr>
<td>Corvex</td>
<td>8.2</td>
</tr>
<tr>
<td>Greenlight</td>
<td>7.5</td>
</tr>
<tr>
<td>Starboard</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Source: Factset, Shark Repellent, HFR Global Hedge Fund Industry Report, BAML Activist Report

Notes:
1. Cash and marketable securities balance
2. Reflects market value of equity holdings as of 31/12/14
Perspectives on the Rise of Shareholder Activism

Activist Hedge Funds Outperforming

Hedge Fund Returns (Net of Fees) p.a.¹

Source: Preqin Hedge Fund Analyst – June 2015
Note:
1. Performance as at 30 April 2015
Activism is not new to Australia, although a more aggressive generation of investors is emerging.
Is it All Bad?

Evidence suggests recent activism has generated positive shareholder value (although long run evidence is mixed)

“...we find that recent activism generates high and persistent announcement period returns... These returns have persisted even as both the number of activists and their interventions have increased”

Krishnan, Partnoy and Thomas, Aug-15

... although the activist “halo” is sometimes undeserved

Icahn Associates Corp. acquired about 6.6 percent of Gannett’s shares and options during the second quarter, with the belief that “value could be created by splitting the issuer into separate print and broadcast companies,” the fund said in a regulatory filing yesterday.

Gannett announced on Aug. 5 that it planned that very separation before Icahn had any contact with the company, according to the filing.
Perspectives on the Rise of Shareholder Activism

Eggleston Principles

Is Activism Consistent or Inconsistent with the Principles?

Corporations Act – Purposes of Act

b) the holders of the shares or interests, and the directors of the company or body or the responsible entity for the scheme:

i. know the *identity* of any person who proposes to acquire a substantial interest in the company, body or scheme; and

ii. have a reasonable *time* to consider the proposal; and

iii. are given enough *information* to enable them to assess the merits of the proposal; and

c) as far as practicable, the holders of the relevant class of voting shares or interests all have a *reasonable and equal opportunity* to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company, body or scheme
Specific Issues: Stake Building and Disclosure

With Herbalife Options, Icahn Repeats Netflix Playbook

Forbes

Majority of 13% stake used options

How Bill Ackman Stalked J.C. Penney

William Ackman’s Pershing Square Capital Management held a clinic on how to stalk a company as an activist investor, using J.C. Penney Co. as the case study.

THE WALL STREET JOURNAL

27% stake built using derivatives

Ackman Amassed Allergan Stake Under Botox Maker’s Radar

Bloomberg Business
Specific Issues: Market Integrity

- **May 2012:** David Einhorn raises concerns on analyst call around Herbalife’s earnings and pyramid scheme
- **Dec 2012:** William Ackman discloses US$1b short position
- **Jan 2013:** Carl Icahn and Dan Loeb disclose 8% and 16% long positions respectively after Icahn’s public argument with Ackman live on CNBC

**Herbalife**

- Einhorn Analyst Call
- Ackman Discloses US$1b Short
- Icahn Discloses 16% Long Position
- Loeb Discloses 8% Long Position

**Allergan**

- Ackman Amassed Allergan Stake Under Botox Maker’s Radar
- Bloomberg Business

- Bill Ackman Gets Into the Hostile Takeover Business
- Bloomberg View

- SEC Examines Pursuit of Allergan by Valeant, Ackman
- The Wall Street Journal

- In Allergan Bid, a Question of Insider Trading
- The New York Times

Source: Press, Company filings, Capital IQ
Perspectives on the Rise of Shareholder Activism

Other Regulatory Issues

Dan Loeb’s Yahoo! Campaign

- Sep 2011 – begins accumulating stake at ~$13.50/share
- May 2012 – Loeb agitates for removal of CEO and Chair – CEO resigns 11 days later
- July 2012 – Loeb recruits Marissa Mayer to CEO position
- Nov 2013 – Yahoo! buys back ~2/3 of Loeb’s position at $29.11/share in selective transaction. Yahoo! shares open at a ~5% discount to this price post-announcement
- Loeb’s total profit from the two year campaign estimated at ~$1bn

Dan Loeb Helped Himself, Not Yahoo

Bloomberg View

Dan Loeb Sends Another Scathing Letter to Yahoo CEO, Board

Yahoo CEO Should Be Fired Over Resume Error: Loeb

Billionaire Dan Loeb Sells Most Of His Yahoo Stock, Makes $1 Billion

Forbes
The Standard Advice to Clients is All Common Sense

- Proactively evaluate business risks – work to ensure no surprises
- Regularly review portfolio of assets
- Consider capital position and ongoing use of funds
- Monitor shareholder register for unusual activity
- Maintain regular, proactive dialogue with shareholders
- Activist engagement preparation – form a dedicated response team
Perspectives on the Rise of Shareholder Activism

However the Reality Can be Harder to Navigate

- Lopsided ability to manage media
- Attacks can be personal
- Distraction from business, can make the activist message self-fulfilling
- Uncertainty can take time to resolve, which can cause further issues

“You and your smirking C.F.O. Gerald Zuehlke (he smirked when confronted with the large losses in the company’s pension plan) are among the worst managers of a public company in America. Arrogance is never acceptable, but it is particularly surprising given the collapse of Potlatch’s shares.” – Dan Loeb public letter to Potlatch

Activist investor Bill Ackman renewed his attack on Herbalife during a CNBC interview Wednesday, likening the nutrition and weight management company to Bernie Madoff.

“We’re shouting from the rooftops. They’ve never had someone like me prepared to say the truth about the company. I’m going to the end of the earth. If the government comes out and determines this is a completely legal business, then I will lobby Congress for them to change the law.” – Ackman
“EFFICIENT, COMPETITIVE & INFORMED”
CURRENT ISSUES IN TAKEOVERS

11 AUGUST 2015

Rodd Levy, Partner, +61 92881518, Rodd.Levy@hsf.com
OUTLINE

• Efficient, competitive and informed market: s602(a)
• Bid conditions
• Intersection with frustrating action policy
EFFICIENT, COMPETITIVE & INFORMED

- Leigh Masel
- Not Richard Eggleston
BID CONDITIONS

• s629 – conditions dependent on bidder’s opinion or in bidder’s control are void

• Side-stepping s629
  – Hair-trigger conditions eg. ASX falls by 1%
  – Vague conditions eg. NGM Resources (2010) – no express materiality test
  – Unlikely to be satisfied eg:
    • due diligence conditions – Goodman Fielder (2001)
    • inevitable change of control eg. Discovery/Cathay Fortune
BIDDER STOCKPILING BREACHES

• Usually, no need to declare until notice of status of conditions notice
• Novus Petroleum (2004)
• Detracts from efficient, competitive and informed market
FRUSTRATING ACTIONS POLICY

- Action which breaches condition unacceptable without shareholder approval
- *Pinnacle No 8 (2001)*
- Guidance Note 12
- Reverses pre-2000 position
- A scheme proposal cannot be frustrated if the board does not support it: GN 12.7; *Transurban*
ISSUES FOR TARGET COMPANIES

• Activity frustrated
• Shareholder approval not often acceptable to counterparty
• Guidance Note 12 revisions 2014
• Regard had to earlier breach
THE LOGICAL POLICY STEP

• Limit frustrating action policy to where bid is certain
• If a bidder chooses conditions which ‘side step’ s629 policy, no protection under frustrating action policy
• Same approach to scheme proposal which relies on recommendation
• Same point made by ASIC in Austock where bid was unfunded
• Re-balance playing field to promote efficient, competitive and informed market
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