



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 35

Collateral benefits in takeovers

Chapter 6 — Acquisition of shares

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From 5 July 2007, this document may be referred to as Regulatory Guide 35 (RG 35) or Policy Statement 35 (PS 35). Paragraphs in this document may be referred to by their regulatory guide number (e.g. RG 35.1) or their policy statement number (e.g. PS 35.1).

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Purpose

RG 35.1 In this guide the ASC sets out the principles on which it will deal with applications for relief from s698 of the Corporations Law (Law). It does not deal with modifications of s636, concerning the sameness of offers made under a takeover scheme.

Section 698

RG 35.2 Subsections 698(1) and 698(3) correspond with s40 of the *Companies (Acquisition of Shares) Act* and Codes (CASA). They prohibit the offeror under a takeover scheme or a takeover announcement from giving, offering to give or agreeing to give a benefit to an offeree under the bid, other than the consideration under the bid, or the bid as varied.

RG 35.3 Subsections 698(2) and 698(4) are new. They prohibit a person who intends to make a bid within four months from giving, offering to give or agreeing to give to a person whose shares may be acquired under the bid, a benefit which it does not propose to give under the bid.

RG 35.4 In each case, the prohibition applies to associates of the offeror and to benefits given or offered or agreed to be given to an associate of an offeree.

RG 35.5 Paragraph 698(5)(b) excludes from the section the purchase of shares in the ordinary course of trading on the Australian Stock Exchange.

Place of section

RG 35.6 Section 698 is one of the linchpins of Ch 6. It is designed to prevent avoidance of the policy stated in s731(d), that offerees must be given equal access to the benefits passing under a bid. The primary expression of that policy is in s636(1) and 674(1), which require the same price to be offered for each share under a bid. Section 698 reinforces those provisions by prohibiting the offer to one shareholder of a collateral benefit which is not available to other shareholders.

Construction

RG 35.7 On a plain reading, the scope of s698 is very wide. As well as benefits passing from the offeror to a shareholder, it applies to

benefits passing from an associate of the offeror to an associate of a shareholder. The term “benefit” itself, which is the ordinary word used in contract law for anything of value received by a person, includes benefits of nominal value. The width of the term is underscored by the express exclusion of benefits given under a bid and the absence of any express requirement that the benefit be attributable to the bid.

RG 35.8 Opinions vary on the construction of s698. The cases decided on the predecessor sections support a wide reading, under which s698 forbids giving the least benefit which could be valuable consideration.

Purposive readings

RG 35.9 A question not tested in the cases is whether a benefit to which the section applies need be referable to the takeover during which it was given. Some practitioners believe that the wide words of s698 should be read down to coincide with what they take to be its policy: only those benefits should be taken to be prohibited which are calculated to affect an offeree’s response to the offer made to him or her under the bid.

RG 35.10 The ASC does not agree that a connection with the bid is an element of the offence created by s698. The points made above about the construction of the section indicate that it was designed to overcome avoidance, by casting a net wide enough to catch all transactions capable of defeating the policy of equal treatment, even at the cost of preventing some innocent transactions from being entered into during a bid.

RG 35.11 If it were an element of the offence that the benefit be referable to a bid, the section could be evaded by the purchase of an asset at an overvalue from an associate of a substantial shareholder, the sale of an asset at an undervalue and other obvious techniques.

RG 35.12 While it is unnecessary for present purposes to take a position on the question, the ASC accepts that the robust view is open that the section is subject to an implied proviso excluding benefits which are wholly and demonstrably attributable to transactions which are both independent of the bid and not calculated to affect any offeree’s response to the bid, such as the provision of goods on the usual commercial terms between parties who normally trade in those goods.

Basic policy

RG 35.13 In accordance with the ASC's understanding of the policy and operation of the section, it will be sparing in the grant of relief. The ASC will require to be satisfied in each case that the relief does not detract from the equal treatment of shareholders.

RG 35.14 The ASC appreciates, however, that in some cases s698 forbids, or may forbid, conduct which is consistent with the policy of the section, and it will grant relief in some of those cases.

Transactions outside the bid

RG 35.15 One class of cases is that mentioned above in connection with the robust view of the section, those in which the benefit is independent of the bid. Because it is open to doubt whether these transactions are prohibited and because they are not within the mischief of the section, the ASC would not take enforcement action (prosecution or restraining orders) over conduct which might be technically in breach of the section, where it was satisfied that it fell into this class.

RG 35.16 Since the ASC will not initiate prosecution and doubts that a court would exercise its discretion to enjoin such conduct, it will not normally grant relief from s698 in these cases. The only practical effect of such relief would be to prevent a court from restraining conduct which it was satisfied provided some shareholders with benefits not available to all shareholders.

Transactions connected with the bid

RG 35.17 There is, however, a small class of transactions (in our experience, about one a year) where s698(1) or 698(3) applies to a transaction with a substantial shareholder in a company which arises out of a bid for that company, but for which relief may be justified. These are transactions which are necessary to allow a bid to be completed, which arise because of matters other than the dispositions of the offeror, and which benefit a shareholder in a capacity other than as shareholder.

RG 35.18 On several occasions a parent company has guaranteed the debts of the target on terms which it is not prepared to continue after having lost control of the target, and a bidder has been prepared to replace that vendor as guarantor if the bid succeeds. The substitution is unexceptionable; if the offeror relieves the holding company of a

detriment, the holding company will of course receive a benefit which other shareholders will not, but will receive it strictly in its capacity as guarantor.

RG 35.19 More difficult examples arise where a parent company:

- (a) holds its shares in the target through a subsidiary and the parent can sell the subsidiary, but the subsidiary cannot sell the shares, without incurring a heavy tax liability; or
- (b) has made a loan to the target, on terms which it is not prepared to continue after having lost control of the target, and the bidder is prepared to replace that vendor as lender if the bid succeeds.

RG 35.20 In these cases, relief may be granted on a case by case basis, only if the applicant satisfies the ASC that the terms on which it is to replace the vendor in its relationship with the target company involve no collateral benefit to the vendor. In the examples given above, the ASC would have to be satisfied that:

- (a) the price to be given by the offeror for the subsidiary values is strictly in accordance with the value attributed to its holding of shares in the target under the bid (it may, of course, be necessary to value other assets or liabilities); or
- (b) the debt was to be purchased at a price that a bank might have paid to take over the loan.

RG 35.21 The offeror's need for relief is greatest in the case of a loan to an insolvent target, but in that case for the offeror to buy the loan at face value would obviously confer a collateral benefit on the vendor. Any proposal that an offeror take over a loan to an insolvent target will be tested against the alternative that the offeror can simply make takeover offers subject to a defeating condition that the loan be released.

Four month rule

RG 35.22 Notwithstanding the adverse comments made on those provisions, the ASC has not received any applications for relief from s698(2) or 698(4). Since relief would tend to defeat the policy of s641(1)(b) and 676(1), the ASC does not expect that relief will be justified, unless on the analogy of the exceptions in those provisions and perhaps on technicalities.

Limits of ASC intervention

RG 35.23 An applicant which proposes to satisfy the ASC that a proposed course of conduct will not involve any collateral benefit to a prospective offeree faces an uphill task. Relief will not be given on the basis of reputation or a bland assurance that there is nothing underhand in the proposal. The case to be made is essentially a commercial evaluation (for instance, that to give \$x for asset y can involve no transfer pricing) and it is not the ASC's function to make fine commercial judgements of this character. Consequently, a quantitative assessment will be required on each occasion, with any necessary expert advice.

RG 35.24 Applications for relief to allow more complex proposals such as the division of the target's assets between the bidder and one shareholder, with a bid for the remaining parcels, have been refused time and again as in appropriate matters for the ASC to decide. The proper body to decide on such a proposal is a general meeting of the target company.

Consultation

RG 35.25 In accordance with the views of the Administrative Appeals Tribunal, the ASC believes that in general it may not grant relief under this guide unless affected parties or their representatives have had an opportunity to comment on the proposed relief. For present purposes, the main (or only) parties affected will be shareholders to whom no benefit is offered or given. Unless they have some interest in or commitment to an outcome of the application, it will ordinarily be sufficient to consult with the directors of the target company as representing their shareholders.

RG 35.26 Unless it is accompanied by a copy of a letter from the applicant to the target company's board, describing the application and inviting the board to make submissions to the ASC, an application should indicate whether the applicant authorises the release of the application to the target company. The ASC does not propose to impose confidentiality conditions on affected parties. If the applicant wishes to impose such a condition, it should do so by direct negotiation with the target.

Applications

RG 35.27 Applications for relief under this guide may be made at any Regional Office and should be accompanied by the appropriate fee.