



**GUIDANCE NOTE 21 Collateral Benefits**

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**Background**

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1. This guidance note has been prepared to assist market participants understand the Panel’s approach to collateral benefits. The examples are illustrative only and nothing in the note binds the Panel in a particular case.
2. Section 602(c)<sup>1</sup> states that a purpose of chapter 6 is to ensure a reasonable and equal opportunity to participate in any benefits.<sup>2</sup> This purpose is applied in:
  - (a) s619, which requires that all offers must be the same<sup>3</sup>

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<sup>1</sup> Unless otherwise indicated, statutory references are to the *Corporations Act (Cth)* 2001.

<sup>2</sup> Equality means equal value, not necessarily identical dealing: see GN 1.24. But see fn 3.

<sup>3</sup> The formal offer provisions are more like identical dealing requirements, which the Panel balances against the equal opportunity principle. To the extent that the former requires the dealings to be the same and the latter allows benefits of equivalent value, they may be inconsistent.

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- (b) s621(3), which requires the consideration offered under a bid to equal or exceed the maximum consideration provided or agreed in the 4 months before the date of the bid<sup>4</sup>
  - (c) s622, which prohibits escalation clauses for acquisitions of bid class securities in the 6 months before the bid is made
  - (d) s623, which prohibits the giving of benefits during the offer period if they are likely to induce acceptances under the bid<sup>5</sup>
  - (e) s627, which prohibits conditions in an off-market bid that allow the bidder to acquire from some but not all acceptors
  - (f) s636(1)(h), which requires a bidder's statement to include information about the consideration provided or agreed in the 4 months before the date of the bid
  - (g) s636(1)(i), which requires a bidder's statement to include information about benefits offered or given in the 4 months before the date of the bid that are likely to induce acceptances under the bid
  - (h) s650A, which requires all unaccepted offers under an off-market bid to be varied in the same way
  - (i) s650B, which entitles previous acceptors of an off-market bid to receive improved bid consideration and
  - (j) s651A, which increases the consideration under a bid if a higher cash sum is paid outside of the bid.
3. Under section 602(a), the acquisition of control over voting shares must take place in an efficient, competitive and informed market.
  4. Section 623 prohibits a benefit that is likely to induce an acceptance and is not offered to all holders in the bid class. Like the equality principle, it articulates a concept of equal value rather than identical dealing. It may also support a wider purpose of ensuring compulsory acquisition only takes place if enough security holders receiving the same consideration accept the offer.

**Introduction**

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5. This guidance note sets out the Panel's approach to collateral benefits. The Panel starts from the idea that unacceptable circumstances will be likely to exist whenever a bidder provides a security holder something of value which it does not offer to other security holders. It articulates factors that the Panel will take into account, but is not exhaustive.<sup>6</sup>

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<sup>4</sup> The former section referred only to cash consideration.

<sup>5</sup> Previously, benefits were prohibited in the 4 months before the bid. See now s636(1)(i).

<sup>6</sup> The range of outcomes from previous Panel decisions (and court decisions on section 623 and its predecessors) reflects the diversity of situations.

## Collateral benefits

6. Whether a collateral benefit gives rise to unacceptable circumstances will depend on all the circumstances.
7. If a collateral benefit has been offered, given or received, the main questions for the Panel are:
  - (a) whether it offends the equality principle (usually the key issue)
  - (b) whether it offends the efficient, competitive and informed market principle
  - (c) whether it contravenes s623 (not essential to a declaration or necessarily resulting in a declaration) and
  - (d) whether it gives rise to unacceptable circumstances
8. Other considerations include:
  - (a) the parties concerned (eg, bidder<sup>7</sup>, target, affected security holder<sup>8</sup>)
  - (b) the nature and context of the benefit and
  - (c) whether the proposal that involves offering, giving or receiving the benefit has been contrived to mask the benefit or to mask that it offends s602 or contravenes s623.
9. For a benefit to be a collateral benefit it must have some connection to a control transaction, temporal or otherwise. The more connected to a control transaction that a benefit appears to be, the more likely it is that it will be regarded as offending the equality principle.
10. While s623 applies during the offer period and s621(3) applies in the 4 months before the date of the bid,<sup>9</sup> s602 has no time limit. A benefit given more than 4 months before a bid may still give rise to unacceptable circumstances, but the Panel would require more cogent evidence that it was connected to the bid.

## The equality principle

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11. Under s602(c), if there is a proposal for the acquisition of a substantial interest (**control transaction**<sup>10</sup>), then, as far as practicable, the holders of the relevant

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<sup>7</sup> Includes the bidder's associates, and may include the target if it offers or agrees to a collateral transaction to facilitate the bid.

<sup>8</sup> Includes a group of security holders. In this note a reference to a target security holder should be read as applying equally to a, or to an associate of a target security holder.

<sup>9</sup> For an off-market bid the date offers are made. For an on-market bid the date the announcement is made. ASIC class order [CO 01/1543] modifies s623 so that, for a market bid, the collateral benefit prohibition applies during the bid period rather than the offer period: see ASIC RG 171.102.

<sup>10</sup> The Panel does not usually consider benefits if they will be subject to scrutiny by a Court under a scheme of arrangement – see *St. Barbara Mines Ltd* [2000] ATP 10.

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class of voting shares<sup>11</sup> must all have a reasonable and equal opportunity to participate in any benefits.

12. However, a collateral benefit will not necessarily offend the equality principle.

*Example 1: A benefit that puts a major shareholder in the same position as other shareholders: Powertel 03<sup>12</sup>*

*Example 2: A benefit that is slight or uncertain: SA Liquor Distributors.<sup>13</sup>*

*Example 3: A de minimis benefit to a security holder whose holding is unlikely to affect control of the target.*

*Example 4: Repayment of a pre-existing loan to the target by a security holder on the security holder selling into the bid and ceasing to be a security holder.<sup>14</sup>*

*Example 5: The security holder receives benefits from the bidder in the ordinary course of the bidder's business and on the same arm's length terms as are freely offered by the bidder to other customers/ clients/ suppliers etc*

*Example 6: Employment benefits reasonably available to other employees, or an agreement relating to termination or future employment of an employee security holder.*

*Example 7: A payment made to every shareholder regardless of whether they accept the offer: Arrow Taxi Services 02<sup>15</sup>*

13. In exceptional cases, a benefit provided to a security holder who starts with interests different to those of other security holders may not offend the equality principle.

*Example: If a bidder also offers to acquire a security holder's employee options at an independently assessed fair price, the benefit involved may not offend the equality principle.<sup>16</sup>*

14. However, the Panel will not accept the argument that, but for the benefit, there would have been no offer (or a lower offer) to all other security holders.
15. The Panel takes the view that, *prima facie*, a benefit offends the equality principle if it is a net benefit. A net benefit is assessed by reference to the

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<sup>11</sup> Or interests.

<sup>12</sup> [2003] ATP 28, especially at [22].

<sup>13</sup> [2002] ATP 21.

<sup>14</sup> For example, *Powertel 03*, *Alpha Healthcare*.

<sup>15</sup> [2007] ATP 11. In this case a 'loyalty' payment as part of the 'co-operative' structure of the company

<sup>16</sup> The Panel may be more likely to conclude that the benefit offends the equality principle if similar offers for other securities are not made by the bidder to the other holders of them or if the security holder is the only holder of the other class.

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commercial balance of advantages flowing to and from the security holder: *Powertel 03*. It is assessed on a 'holistic' rather than 'atomistic' approach.<sup>17</sup> If there is no net benefit, then *prima facie* the equality principle will not be offended (but see below on s623 and inducement).

16. Factors affecting the view of the Panel as to the balance of advantages include:
- (a) the substance and commercial reality of the transaction
  - (b) the context in which the benefit is given or the consideration is given up
  - (c) the overall effect of the transaction: *Becker Group 01*<sup>18</sup>
  - (d) an objective assessment of the transaction (rather than the parties' intentions).
17. While the existence of a net benefit is ultimately a matter for the Panel, there are a number of ways that a person might seek to establish that there is no net benefit,<sup>19</sup> including:
- (a) market testing of the transaction, for example, by a public sale process<sup>20</sup>
  - (b) an independent valuation of the transaction or
  - (c) an expert's opinion about whether there is a net benefit.

Of these, market testing is the preferable way to seek to establish no net benefit. If not used, the reasons should be explained.

18. Combining these provides stronger evidence that there is no net benefit. For example, an independent valuation which concludes that the value is fair, combined with evidence of open and transparent testing of the price, is likely to satisfy the Panel that, at least in relation to price, the transaction does not confer a net benefit.

### Market testing

19. Open, transparent testing of the price to be paid for an asset requires that:

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<sup>17</sup> *Boral Energy Resources Ltd v TU Australia (Queensland) Pty Ltd* (1998) 28 ACSR 1 at p 39 explains: *If an atomistic view of benefit is taken, then all that s 698(1) requires, with its reference to "any benefit", is that the non-bid transaction confer at least one benefit not replicated in the bid transaction (or takeover scheme). The preferred holistic view instead takes into account whatever rights or benefits are conferred by each transaction, to be netted off against whatever rights or benefits are thereby given up, to the extent such benefits are commensurable at least in an approximate sense. The resultant net benefit is to be compared under each transaction. Only if there is overall disparity in favour of the party to the non-bid transaction is s 698(1) contravened. This is in the sense of a balance of advantage, profit or good in favour of the party to the non-bid transaction.*

<sup>18</sup> [2007] ATP 13

<sup>19</sup> This paragraph deals with establishing no net benefit. See also later discussion of security holder approval of a net benefit to avoid a declaration of unacceptable circumstances.

<sup>20</sup> In *Becker Group 01*, [2007] ATP 13 at [57] the Panel said: *Despite the interconnectedness of the transactions, the Panel would have been more likely to accept that no unacceptable benefit was being conferred on BFG if the process of, or purchase price for, sale of the Film Business had been publicly and transparently tested in a competitive environment.*

**Collateral benefits**

- (a) potential bidders know of the proposed transaction, and have enough time and information to assess whether to bid and how much to bid
  - (b) the highest bidder has a real opportunity to acquire the asset and
  - (c) there is no real barrier to becoming a bidder.
20. Market testing may not establish the price in all cases (eg, if an asset has special value to one security holder – see below).

**Independent valuation**

21. An independent valuation should establish the price that might be negotiated in an open, unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length: *Email 03*.<sup>21</sup>
22. An independent valuation, however, does not mean that a transaction at fair market value will never give rise to unacceptable circumstances.<sup>22</sup> The Panel will always look at the substance and commercial reality of the transaction. On this basis it may be clear that the transaction confers a collateral benefit that gives rise to unacceptable circumstances, even though it is at fair market value.

*Example 1: An option (itself acquired for market value) to acquire an asset for fair market value but without exposure to competition.*

*Example 2: An asset at fair market value but which has special value to the acquirer, so it could not be said that there is no net benefit.*

23. The independent valuation should look at:
- (a) the substance and commercial reality of the transaction
  - (b) all the circumstances of the benefit received and given up
- Example: it may be appropriate to take into account a parent company's power to control the target as well as the effect of that control on the target's ability to repay a loan by a parent to a target: Alpha Healthcare.*<sup>23</sup>
- (c) whether the asset has special value,<sup>24</sup> such as:
    - (i) when it cannot be replicated or substituted, for example, a shopping centre complex or
    - (ii) if synergies are available to a potential acquirer, for example, a mineral deposit near the potential acquirer's existing infrastructure (ie, making its exploitation more economic).

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<sup>21</sup> [2000] ATP 05.

<sup>22</sup> *PowerTel 03* [2003] ATP 28 does not say otherwise.

<sup>23</sup> [2001] ATP 13.

<sup>24</sup> The Panel would not expect the special value to make the price so high that the transaction became uncommercial, but would expect the price to take account of that value.

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If there is special value, the Panel is more likely to consider that there is a collateral benefit.

- (d) whether the asset's value is impaired (eg, by a third party right).
24. The Panel may require a valuation as part of its proceedings. Possible approaches include the Panel:
- (a) inviting the applicant, target, bidder or the security holder to obtain a valuation: *Forest Place*<sup>25</sup>
  - (b) appointing an independent expert to assist in assessing the assumptions and methodology of valuations provided by the parties: *Email 03*<sup>26</sup> or
  - (c) obtaining a valuation itself: *Alpha Healthcare*<sup>27</sup>.

**Expert's opinion**

25. An expert's opinion about whether there is a net benefit may incorporate a valuation by the expert<sup>28</sup> or by another person.<sup>29</sup> It should:
- (a) meet the standards in ASIC RG 111 "*Content of expert's reports*" and RG 112 "*Independence of experts*"
  - (b) contain full disclosure of the factors that the expert took into account and methodology and
  - (c) be clear and concise in its conclusions.
26. The Panel may question the methodology even in the absence of manifest error: *Auspine*<sup>30</sup>

**The efficient, competitive and informed market principle**

27. A collateral benefit may offend the efficient, competitive and informed market principle in s602(a): *Becker Group 01*.<sup>31</sup>
28. A key consideration for the Panel is whether the arrangements have had the effect of dissuading alternative bidders/ buyers from coming forward.
- Example: If a debt owed by a security holder to the target is agreed to be taken over by the bidder from the security holder, and is discounted, the agreement should contemplate that a higher bidder is entitled to the same arrangement. The agreement may provide for compensation to the original bidder in accordance with Guidance Note 7.*

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<sup>25</sup> [2004] ATP 03

<sup>26</sup> [2000] ATP 05 at [40]

<sup>27</sup> [2001] ATP 13 at [63]

<sup>28</sup> As in *Becker Group 01*.

<sup>29</sup> As in *Auspine Limited* [2007] ATP 18.

<sup>30</sup> [2007] ATP 18 at [50]-[51].

<sup>31</sup> [2007] ATP 13, especially at [62].

**Collateral benefits**

29. A bidder that does not fully disclose the transaction giving rise to the benefit, as well as the benefit itself, risks a declaration on this basis.

**Section 623 and inducement**

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30. Under section 623(1):

***Collateral benefits not allowed***

- (1) *A bidder, or an associate, must not, during the offer period for a takeover bid, give, offer to give or agree to give a benefit to a person if:*
- (a) *the benefit is likely to induce the person or an associate to:*
- (i) *accept an offer under the bid; or*
- (ii) *dispose of securities in the bid class; and*
- (b) *the benefit is not offered to all holders of securities in the bid class under the bid.*

31. The balance of judicial authority<sup>32</sup> and Panel decisions supports a "net benefits" approach to section 623, looking at the commercial balance of advantages flowing to or from the non-bidder from a transaction which is sought to be impugned.

32. The Panel also considers that there may be inducement,<sup>33</sup> even if there is no net benefit which leads to unacceptable circumstances.

*Example 1: A benefit received by the security holder or given up by the other security holders that is difficult to value.*

*Example 2: A pro rata payment to shareholders if the formula favours a particular shareholder and therefore would be likely to be an inducement.*

33. In deciding if a transaction is likely to induce an acceptance, the Panel will look at:
- (a) the likely effect of the transaction. The Panel will objectively assess whether the transaction was likely to affect the shareholder's attitude towards the bid<sup>34</sup>
- (b) how independent of the bid the transaction appears to be

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<sup>32</sup> Including the majority in *Sagasco Amadeus v Magellan Petroleum* (1993) 113 ALR 23; *Boral Energy Resources Ltd v TU Australia (Queensland) Pty Ltd* (1998) 28 ACSR 1

<sup>33</sup> *Powertel 03* [2003] ATP 28 at [31]. However, whether the state of affairs led to unacceptable circumstances depended on whether it tended to defeat the equal opportunity principle not simply on whether s623 was breached: see [40].

<sup>34</sup> *Citect Corporation Ltd* [2006] ATP 6 at [59].

- (c) timing (not necessarily unacceptable<sup>35</sup>) and
- (d) materiality and whether there is any net benefit.<sup>36</sup>

*Example: A risky loan that was on favourable terms to the target being repaid to a controlling security holder may be seen as removing a detriment to that shareholder rather than as an inducement.*

## Giving rise to unacceptable circumstances

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34. Factors influencing whether a collateral benefit gives rise to unacceptable circumstances include:
- (a) whether it was offered, given or received when a control transaction was contemplated
  - (b) whether it will be given or received irrespective of the control transaction outcome
  - (c) whether it and the control transaction are linked, for example, through bid conditions or an understanding
  - (d) whether there is a pre-existing relationship or a series of independent transactions explaining it and
  - (e) whether security holders have approved the benefit.

### Security holder approval

35. A collateral benefit is unlikely to give rise to a declaration of unacceptable circumstances if it is approved by fully-informed, non-associated security holders.<sup>37</sup>
36. Under item 7 of section 611, shareholders can approve an acquisition of shares, provided that the parties to the acquisition do not vote and shareholders are given all necessary information. No equivalent exception exists for collateral benefits, but the Panel is prepared to accept by analogy that approval is likely to avoid a collateral benefit giving rise to unacceptable circumstances.<sup>38</sup>
37. In limited circumstances where a meeting is impractical, the Panel may accept other forms of majority non-associated consent, such as the written agreement of security holders to the arrangement or a form of ballot. However, combining a ballot for a collateral transaction with an acceptance form would not be acceptable because it does not allow the security holder independent choice on the approval of the collateral benefit.

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<sup>35</sup> For example, it may be inevitable that a connection needs to be severed at the same time as the bid.

<sup>36</sup> *Citect Corporation Ltd* [2006] ATP 6 at [50].

<sup>37</sup> There may still be a contravention of section 623.

<sup>38</sup> See *Becker Group Limited 01* [2007] ATP 13.

## **Related material**

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GN 6: Minimum price requirement

ASIC RG 35: Collateral benefits in takeovers

ASIC RG 145: Collateral benefits – Takeovers funding and pre-bid purchases

ASIC RG 163: Takeovers: minimum bid price principle

ASIC Class Order 00/2338: Relief from minimum bid price principle

## **Publication history**

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