

## **GUIDANCE NOTE 14: FUNDING ARRANGEMENTS**

### **Overview**

This Guidance Note discusses when the funding arrangements for the cash component of the consideration for a takeover bid may give rise to unacceptable circumstances. It emphasises that bidder must at all times have reasonable grounds to expect that it will have sufficient funding arrangements in place to satisfy full acceptance of its offers when the bid becomes unconditional.

It points out that what may be required to satisfy this requirement may change throughout the period from the announcement of the bid to the time of payment of accepting target shareholders, with its becoming necessary for the arrangements to become more definite as time progresses, depending on the circumstances of the bid. The Note looks at conditions of the bid and their relationship with conditions precedent to drawdown for the funding.

The Note looks at several common arrangements relating to funding and indicates the Panel's requirements to ensure that unacceptable circumstances do not arise from them.

In addition, the Note gives some guidance as to disclosure issues associated with funding of the bid.

The Guidance Note also expresses concern that reliance on clauses purporting to entitle a bidder to transfer the shares of an accepting shareholder to it unconditionally may be unacceptable where the bidder does not in fact make payment for those shares to all accepting shareholders.

## Introduction

14.1 In this Guidance Note, the Panel sets out its views on circumstances relating to the funding arrangements for the cash component of the consideration for takeover bids that may be considered to be unacceptable. Unlike the courts, the Panel has jurisdiction to consider whether circumstances are unacceptable not only by reason of disclosure issues (in which case, appropriate court decisions may be relevant for the Panel to consider) but also by reason of the financing arrangements themselves and their terms and conditions. The Guidance Notes also makes some observations in relation to appropriate disclosure of those arrangements or of matters associated with them. As disclosure issues are not the primary focus of this Guidance Note, the observations on disclosure are shown separately and in a contrasting typeface. On disclosure in relation to financing arrangements, readers should also consult ASIC Practice Note 37 as well as the Panel's decisions in *Taipan Resources NL(No 3)*,<sup>1</sup> *Pinnacle VRB Ltd (No 6)*,<sup>2</sup> *Taipan Resources NL (No 10)*,<sup>3</sup> *Taipan Resources NL (No 11)*,<sup>4</sup> and *Goodman Fielder Ltd*.<sup>5</sup>

14.2 The Panel's main concerns in relation to funding arrangements are that:

- (a) at all relevant times, the bidder have reasonable grounds to expect that it will have sufficient funding arrangements in place to satisfy full acceptance of its offers when the bid becomes unconditional (a **Reasonable Basis**); and
- (b) the bidder actually pay accepting shareholders in accordance with its obligations under the contracts formed by those acceptances.

Associated with these concerns are also concerns relating to the appropriateness and timeliness of disclosure relating to funding arrangements and that this disclosure is updated as relevant circumstances change throughout the takeover bid process.

14.3 The Panel considers that it is likely that there would be a false market in the target's securities, and hence unacceptable circumstances under paragraph 602(a) of the Corporations Act (**Act**) if:

- (a) a bidder announces a bid without either adequate funding arrangements already in place<sup>6</sup> or a Reasonable Basis; or
- (b) when the bidder announced the bid it had adequate funding arrangements in place, but later those arrangements fail and are not replaced promptly; or

---

<sup>1</sup> [2000] ATP 17; 37 ACSR 173

<sup>2</sup> [2001] ATP 11; 38 ACSR 564; 19 ACLC 1249

<sup>3</sup> [2001] ATP 5

<sup>4</sup> [2001] ATP 16

<sup>5</sup> [2003] ATP 1; 44 ACSR 254

<sup>6</sup> Which would constitute a Reasonable Basis, as well.

## Funding Arrangements

- (c) when the bidder announced the bid it had a Reasonable Basis, but later changes in circumstances mean that it no longer has a Reasonable Basis; or
- (d) the structure of the bid changes (e.g. declaring the bid free from a condition or an increase in bid consideration) so that the existing arrangements become inadequate; or
- (e) a bid is freed from all defeating conditions when the relevant financing arrangements remained conditional on material factors and there is a real risk that those conditions may not be fulfilled.

The Panel would be entitled, if it found that unacceptable circumstances existed, to make any order necessary to rectify those circumstances (refer to section 657D and GN 4).

### Nature of funding arrangements

14.4 A bidder may choose to fund its bid from any source it chooses; the funds may come from internal sources (either cash reserves or from liquidating assets – see [14.17] and [14.19]) or by loan or other accommodation from another member of the same corporate group<sup>7</sup> or external financiers. A debt funding may be a new facility (either generally or specifically for the bid) or the bidder may draw down on existing facilities – see [14.18]. The issue in each case is whether the bidder has at all times a Reasonable Basis.

#### Disclosure Notes:

- (1) The bidder must disclose in its bidder's statement or other disclosure documents, in meaningful and clear language, the nature and details of its funding arrangements. Bidders should seek to make their disclosures as concise as possible, consistent with ensuring complete clear and meaningful disclosure on all relevant issues.
- (2) For example, the bidder must demonstrate that it or its lender has the necessary financial resources to satisfy its obligations. If the lender is a well-known and reputable Australian bank, this may require only that it is identified. In the case of other financial institutions (such as international banks or Australian non-banks), the circumstances may mean that this disclosure may only need to be quite limited – for example, the latest audited net assets of the institution and a description of any prudential regulation to which it is subject.
- (3) The financial terms of the funding arrangement (interest rate, repayment, covenants, security) do not usually need to be disclosed. However, if the bid is likely to result in a continuing minority shareholding in the target (as for instance if a bid is declared free of a minimum acceptance condition which would trigger compulsory acquisition procedures under Part 6A.1), and the bidder intends to rely on the target for the payment of interest on, repayment of or security for any liability, or if the target will require on-going funding which may be affected by the bidder's funding, details of the arrangements contemplated should be disclosed.

14.5 It is also entirely acceptable for the bidder to have alternative arrangements in place. For example, the bidder may have cash reserves available sufficient to meet its obligations but choose to seek debt funding to meet those obligations for its own reasons. However, typically one of those alternatives must on its own be sufficient to provide a Reasonable Basis.

---

<sup>7</sup> To make this Guidance Note easier to read, it does not always refer separately to a group funder which itself has or arranges the underlying financial arrangements for the bid funding and makes them available to the bidder. However, subject to complying with [14.20], relevant references to the bidder should be read as including such a group funder.

**Disclosure Note:** In this case appropriate disclosure of all alternatives (including the issues discussed at [14.17]-[14.19]) is required and not just of one of the potential sources of funding.

### Announcement of bid

- 14.6 Section 631 of the Act effectively requires that a bidder only announce a takeover bid after the most careful and responsible consideration and when the bidder has every reason to believe that it can and will be able to implement the offer.<sup>8</sup> Although the Act does not expressly require that a bidder making a cash bid have available cash resources to satisfy full acceptance of its offers, paragraph 631(2)(b) requires that a person not announce 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 offer under the bid are accepted." The Panel considers that this requires that when announcing a proposed bid the bidder must have a Reasonable Basis.<sup>9</sup>
- 14.7 This requirement is reinforced by other provisions of the Act. For example, section 588G will usually provide a sanction against directors of a bidder who authorise the dispatch of offers for which acceptances are not paid due to lack of funding where there were reasonable grounds for the directors to believe that the bidder would be unable to pay.<sup>10</sup>

### What is a Reasonable Basis?

- 14.8 The answer to this question will depend on all the circumstances of each case. It is judged objectively and not solely, or even primarily, on the basis of the bidder's beliefs (or those of its, or its parent company's, directors).
- 14.9 The following are examples of situations in which it is unlikely that the bidder will have a Reasonable Basis if external funding is the source for the funding (and not merely an alternative being pursued where the bidder has sufficient internal resources):
- (a) the financing is the subject of an informal or unenforceable arrangement;
  - (b) except where [14.22] applies, the financing remains subject to internal approval by the lender;<sup>11</sup>

---

<sup>8</sup> See ASIC Practice Note 59, particularly paragraphs 3-5, 11-12 and 30. This policy is similar to General Principle 3 of the *London City Code on Takeovers and Mergers*. See also the Panel's decisions in *Realestate.com.au.Ltd* [2001] ATP 1; 37 ACSR 218; 19 ACLC 618 and *Brisbane Broncos Ltd (No 3)* [2002] ATP 3 and the decision of Santow J in *Re Archaean Gold NL* (1997) 15 ACLC 382.

<sup>9</sup> Other jurisdictions explicitly require that funding arrangements be in place. For example, Rule 24.7 of the *City Code* provides that an "offer document must include confirmation by an appropriate third party (eg the offeror's bank or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer". See also Item 1007 (*Source of amount of funds or other consideration*) of Regulation M-A (Mergers and Acquisitions) (promulgated by the Securities and Exchange Commission under the Securities Act 1933), 17 CFR § 229.1007.

<sup>10</sup> This section only applies to Australian bidder companies. There are likely to be similar insolvency provisions operating in other jurisdictions. In addition, if the bidder is an Australian subsidiary of a foreign parent, section 588V will impose liability on the parent company if the bidder incurred the debts without reasonable grounds to believe it would be able to meet those debts.

<sup>11</sup> See *Taipan Resources NL (No 10)* [2001] ATP 5.

## Funding Arrangements

- (c) the financing is on a “best endeavours” basis;<sup>12</sup>
- (d) the financing has unusual repayment or expiry provisions that may result in the financing not being available to pay for acceptances;<sup>13</sup>
- (e) the financing is subject to conditions precedent to drawdown and the bidder does not have a reasonable basis to expect that those conditions will be satisfied or waived in circumstances where the bid is or becomes unconditional (see also [14.12] and [14.13]);
- (f) the financing is subject to documentation, unless there is a binding commitment in place which is sufficiently detailed to provide the bidder with a reasonable basis to expect that it will have sufficient funding arrangements in place to meet its obligations (see also [14.23]-[14.24]); or
- (g) the lender has insufficient funds to pay for the shares, even if the loan documents are in order.

14.10 The degree of certainty that will be required as to the availability of funds to ensure that there is a Reasonable Basis can increase throughout a bid, especially as the likelihood of the bidder being required to pay accepting shareholders increases through conditions of the bid being fulfilled or waived. Similarly, greater certainty will be required if the bidder proposes to pay accepting shareholders faster than originally provided.

14.11 Accordingly, when the bidder announces its bid, gives the target and ASIC (and the market) its bidder’s statement and sends its offers, even if external debt funding is the essential source of funding, the bidder may (subject to the matters mentioned in [14.9] and to [14.20] in relation to intra-group arrangements and [14.23] in relation to documentation) have a Reasonable Basis even if the relevant arrangements have not been formally documented,<sup>14</sup> or they remain subject to conditions precedent to drawdown,<sup>15</sup> provided that there is a binding commitment in place which is sufficiently detailed to give the bidder a Reasonable Basis. However, as defeating conditions of the bid are satisfied (including by acceptances) or as the bid is declared, or becomes, free from those conditions, the financing arrangements must become more certain (both legally and commercially) to ensure that the bidder then still has a Reasonable Basis.

14.12 If and while a bid is conditional and the bid financing has material conditions precedent to drawdown which are beyond the power of the bidder to satisfy, either or both:

- (a) the bid should include corresponding defeating conditions; and

<sup>12</sup> See *Taipan Resources NL (No 10)* [2001] ATP 5.

<sup>13</sup> See for example *ICAL Ltd v County Natwest Securities Australia Limited* (1988) 6 ACLC 467.

<sup>14</sup> See for example *Target Petroleum NL v Petroz NL* (1987) 16 FCR 1, *Goodman Fielder* [2003] ATP 1; (2003) 44 ACSR 254, *Pinnacle VRB Ltd (No 6)* [2001] ATP 11; (2001) 38 ACSR 564 and *Taipan Resources NL (No 10)* [2001] ATP 5.

<sup>15</sup> See for example *ACI Ltd v Rossington Holdings Ltd* (1992) 106 ALR 221 and *Goodman Fielder* [2003] ATP 1; (2003) 44 ACSR 254.

## Funding Arrangements

- (b) the bidder's statement should disclose clearly and prominently the material conditions to drawdown.

**Disclosure Note:** To the extent that the first alternative is used, the defeating condition should make it clear that the condition corresponds to a condition to drawdown of the financing. If there are material conditions precedent to drawdown which are beyond the power of the bidder to satisfy, the bidder's statement should also disclose the basis on which the bidder believes that it will be able to satisfy those conditions.

- 14.13 The bid should not be declared, or allowed to become, unconditional<sup>16</sup> if:
- (a) the financing arrangements on which the bidder will rely remain unrecorded in final and binding documents;
  - (b) those arrangements remain subject to commercially significant conditions precedent to drawdown which are outside the control of the bidder; or
  - (c) there is a material risk that any condition precedent to drawdown (whether or not within the control of the bidder) may not be fulfilled.

**Disclosure Note:** If the bid is declared or allowed to become unconditional, disclosure should also be made in a supplementary bidder's statement of the status of the conditions precedent a drawdown contained in the financing arrangement. If the financing remains subject to conditions precedent to draw down which are outside the control of the bidder when the bid is declared, or becomes, unconditional, this disclosure must include the basis on which the bidder believes that it will be able to satisfy those conditions.

### How much funding?

- 14.14 If the bid covers securities that are issued during the offer period,<sup>17</sup> the bidder's funding arrangements should be sufficient to pay for those additional securities. However, if the bidder has reasonable grounds to expect that acceptances will not be received in respect of particular securities,<sup>18</sup> the funding arrangements need not extend to those securities.<sup>19</sup>

**Disclosure Note:** The bidder should disclose the basis (including any arrangements forming part of that basis) for its expectation that acceptances will not be required for those securities.

- 14.15 If the financing is denominated in a foreign currency, in order to establish a Reasonable Basis, the bidder may need to ensure that there will be sufficient funds available in Australian currency. It may do this by either or both:
- (a) having hedging arrangements; and

---

<sup>16</sup> The main situation where declaring a bid free of conditions will generally not create unacceptable circumstances is when the bid financing is subject to a minimum acceptance condition in connection with the bid. The Panel understands that it is often practically impossible to obtain a formal waiver of a financing condition in these circumstances. The bidder must take reasonable steps to ensure that the financing will be available, notwithstanding that the minimum acceptance condition is not fulfilled, even if a waiver of the financing condition is not obtained or to ensure that alternative financing which is not conditional on the minimum acceptances is obtained.

<sup>17</sup> Refer subsection 617(2) of the Act.

<sup>18</sup> For example, because the bidder or one of its subsidiaries already holds securities in the bid class or because there are arrangements under which a target shareholder has agreed not to accept the bid or convertible securities are materially out of the money.

<sup>19</sup> In certain circumstances, arrangements with target shareholders may be constrained by section 606 of the Act.

## Funding Arrangements

- (b) demonstrating that the financing will be sufficient even if there is a material adverse exchange rate movement.<sup>20</sup>
- 14.16 The bidder's initial funding arrangements need not extend to cover additional amounts that might be required if the bidder were to increase the offer price or offer to pay costs and expenses.<sup>21</sup> However, if the amount payable under the bid increases after it is made, the bidder will not have a Reasonable Basis unless it has financing arrangements in place in relation to the increase as well as the original amount. This does not need to be the same arrangement as when the bid was originally made.

### Some special cases

#### *Reliance on cash reserves*

- 14.17 If the bidder is relying on cash reserves (its own or those of its group), in order to have a Reasonable Basis, the bidder should ensure that either:
- (a) those reserves are not subject to security interests, rights of set off or other arrangements (e.g. the reserves are required for other company or group operations) that may materially affect its ability freely to use them to pay accepting shareholders; or
  - (b) it has alternative finance available on a standby basis or other sources of readily available cash to meet those obligations.

**Disclosure Note:** Disclosure will be required of both the cash reserves (including the form in which they are held) and the stand-by funding or other source of cash relied on by the bidder.

#### *Reliance on undrawn facilities*

- 14.18 If the bidder is relying on drawing down on pre-existing facilities in order to have a Reasonable Basis, the bidder should ensure that either:
- (a) funds under the facilities are immediately available for drawdown and are not required for other company or group operations; or
  - (b) it has alternative finance available on a standby basis or other sources of readily available cash to meet those obligations.

**Disclosure Note:** Disclosure will be required of both the amounts available for drawdown under the existing facilities and the stand-by funding or other source of cash relied on by the bidder.

#### *Reliance on asset realisations*

- 14.19 In certain circumstances, the bidder may be able to rely on its (or its group's) non-cash resources to establish a Reasonable Basis. If it is relying on it (or group companies) realising non-liquid assets<sup>22</sup> to fund its obligations under the bid, those assets must be able to be realised on a timely basis for a sufficient cash amount. It may be necessary for the bidder also to have

<sup>20</sup> See *Parker & Parsley Petroleum Australia Pty Ltd v Gantry Acquisition Corp* (1994) 13 ACSR 689.

<sup>21</sup> See *AAPT Ltd v Cable and Wireless Optus Ltd* (1999) 17 ACLC 974, at 1010 and *Associated Dairies Ltd v Central Western Dairy Ltd* (1993) 117 ALR 433, at 439. Cf *Re Archaean Gold* (1997) 15 ACLC 382, at 384.

<sup>22</sup> In *Taipan Resources NL (No 10)* [2001] ATP 5 and *Taipan Resources NL (No 11)* [2001] ATP 16 the relevant asset was a portfolio of listed shares. However, the major part of the portfolio was a single parcel of more than 10% in another company – in the circumstances this was a non-liquid asset.

## Funding Arrangements

alternative finance available on standby basis or other sources of readily available cash in order for it to have a Reasonable Basis.

**Disclosure Note:** Disclosure will be required of both the non-cash resources identified for this purpose (including the assets involved and the state of any arrangements for the realisation of those assets) and the stand-by funding or other source of cash relied on by the bidder.

### *Reliance on Group support*

14.20 If the bidder's funding is being provided by or through a member of the same corporate group, the arrangements for this should be binding on all parties (including that the parent of the group should agree to procure compliance by group members with the arrangements) and fully documented. Where lender and bidder are part of the same wholly-owned group, those documents should be finalized and signed by all parties before the bidder's statement is given to ASIC.<sup>23</sup> This will also be the case in other groups, unless the existence of outside interests between lender and bidder means that substantial negotiations of an arms length kind are required in order to negotiate and finalise the facility and its documentation, in which case the lender will be treated by the Panel as an "external" lender.

**Disclosure Note:** The terms of these intra-group arrangements should be disclosed to the extent that they are relevant to the availability of the funding in the bidder's statement.

### *Finance that is subject to approval*

14.21 In general the bidder will not be able to rely on non-binding commitment by financier to provide funds on terms which have not yet been determined in order to establish that it has a Reasonable Basis. This will be so even if the bidder believes that the financier will honour its commitment. In this case, the approval needs to be obtained and the facility sufficiently documented in order to establish a Reasonable Basis.

14.22 However, if the bidder is of substantial worth (relative to the cash required for the bid) and reasonably believes it would have access to other sources of funds, it may have a Reasonable Basis even where the intended source of funds is a debt funding facility that remains subject to approval by the lender's credit committee. This would only apply if the lender has informed the bidder that credit committee approval is likely to be obtained swiftly.

### *Finance that is subject to documentation*

14.23 Where finance is subject to documentation when the bid is announced or the bidder's statement is lodged, documentation should be completed and signed before sending offers to the target shareholders.

---

<sup>23</sup> If the Group lender's ability to fund the bid will depend on its being able to draw down on an external facility, the internal facility should have an appropriate condition precedent to drawdown. There is a limited instance in which the internal facility may be completed and signed at the same time as an external facility – this is where fundamental terms of the internal facility will depend on the finalisation of all terms of the external facility (for example when payments under the internal facility will need to be paid on certain days into a particular bank account to ensure that those funds are available to make payments under the external facility and this can not be dealt with simply by reference to the internal payment being made a specified period before the external payment to an account nominated by the internal lender).

## Funding Arrangements

**Disclosure Note:** Any material changes to the terms of the finance (e.g. arising from the documentation of the arrangement) from that disclosed in the bidder's statement should be disclosed to target shareholders in a supplementary bidder's statement.<sup>24</sup>

- 14.24 The required documentation will ordinarily be the actual loan or other financing documents, which should be finalised and executed. All security documents should be finalised and executed before the bid becomes unconditional. However, a detailed and binding facility or commitment letter or term sheet, that is signed and agreed between the parties and sets out all material terms and conditions will usually be an acceptable alternative. As the bidder is the only relevant party to the funding arrangements, the Panel expects that it will be able at all times to produce evidence to the Panel that it has at that time a Reasonable Basis. A failure by a bidder to do so may lead the Panel to draw an inference that the bidder does not have a Reasonable Basis.

### Changes in funding arrangements

- 14.25 A bidder may alter its funding arrangements after it makes its bid if the altered arrangements give it a Reasonable Basis (judged at the time of the alteration) and the changes do not materially adversely affect target shareholders, and the market for target (and bidder) shares generally.

**Disclosure Note:** Any material changes to the terms of the finance disclosed in the bidder's statement should be disclosed to target shareholders in a supplementary bidder's statement. Similarly, changes in circumstances which affect the availability or sufficiency of the arrangements disclosed in the bidder's statement should also be disclosed in a supplementary bidder's statement.

### Delivery versus payment

- 14.26 As the High Court observed in *George Hudson Holdings Limited v Rudder*,<sup>25</sup> the usual rule in transactions involving payment in return for a transfer of property is that the transfer of title to the property only occurs when payment is made, unless the contract provides otherwise. Offers under bids, however, often contain provisions allowing shares the subject of acceptances to be transferred before payment is made. If payment is not made, accepting target shareholders become unsecured creditors of the bidder. The Panel considers that unacceptable circumstances would be created if a bidder transferred shares under this kind of clause, for instance by a message to the SCH relating to an acceptance sub-position, and then did not pay the consideration. If that occurred, the Panel would be likely to make orders restoring the shares transferred to the relevant accepting offerees.

### Equity funding

- 14.27 This Guidance Note focuses on debt facilities used to fund a bidder's obligations under a bid. A bidder might also, or as an alternative, fund those

---

<sup>24</sup> The Panel expects that the target would give its consent under ASIC CO 00/344 to allow a bidder's statement to be amended between being lodged and being sent where the amendment is **merely** to record that the funding facility described in the lodged statement is now documented in signed facility documents.

<sup>25</sup> (1973) 128 CLR 387.

**Funding Arrangements**

obligations, in whole or in part, by raising equity. The Panel would apply the principles set out in this Guidance Note, with the necessary amendments, to an equity-based funding facility. The Panel is considering whether specific guidance should be given by it on this subject.

---

**Publication History**

First Issue      4 March 2004