



Australian Government

Takeovers Panel

**Reasons for Decision
Pacific Energy Limited
[2019] ATP 20**

Catchwords:

Decline to make a declaration – scheme of arrangement – lock-up devices – proposal deed – superior proposal –

Matching right – break fee

Corporations Act 2001 (Cth), sections 602, 657A

Guidance Note 7 – Lock-up devices

GBST Holdings Limited [2019] ATP 15, Ross Human Directions Ltd [2010] ATP 8

Interim order	IO undertaking	Conduct	Declaration	Final order	Undertaking
NO	YES	YES	NO	NO	NO

INTRODUCTION

1. The Panel, Ron Malek (sitting President), Rory Moriarty and David Williamson declined to make a declaration of unacceptable circumstances in relation to the affairs of Pacific Energy Limited. Pacific Energy had entered into a scheme implementation deed with QIC Bidco for its acquisition. The application concerned the conduct of Pacific Energy in addressing a competing proposal, including agreeing to pay a break fee to the competing bidder (APC Bidco). The Panel considered that Pacific Energy had facilitated a materially higher offer and the agreement to pay the break fee to the competing bidder was not anti-competitive or coercive. The Panel was not satisfied that the circumstances were unacceptable.

2. In these reasons, the following definitions apply.

APC Bidco	APC Bidco Pty Ltd, a wholly owned subsidiary of APC Holdco Pty Ltd controlled by the other members of the Consortium
APC Proposal Deed	the APC Proposal Deed dated 10 September 2019 between APC Bidco and Pacific Energy
APC SID	the form of scheme implementation deed accompanying the Consortium’s definitive proposal letter and executed by APC Bidco
Consortium	OPSEU Pension Plan Trust Fund, Infrastructure Specialist Asset Management Limited in its capacity as trustee of one or more funds managed by Infrastructure Capital Group Limited and APC Bidco
Consortium Break Fee	the break fee payable to APC Bidco under the APC Proposal Deed as described in paragraph 8

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Pacific Energy	Pacific Energy Limited
QIC Bidco	QGIF Swan Bidco Pty Ltd, a wholly owned subsidiary of QGIF Swan Holdco Pty Ltd controlled by a stapled investment vehicle comprising QIC Investments No. 1 Pty Ltd as trustee of QIC Global Infrastructure Fund (Australia) No. 1 Trust and QIC Infrastructure Management No. 2 Pty Ltd as trustee of QIC Global Infrastructure Fund (Australia) No. 2 Trust
QIC SID	the scheme implementation deed dated 23 July 2019 between QIC Bidco and Pacific Energy

FACTS

3. Pacific Energy is an ASX listed power generation project developer and owner (ASX code: PEA).
4. On 24 July 2019, Pacific Energy announced that it had entered into the QIC SID under which QIC Bidco would acquire 100% of Pacific Energy shares for \$0.975 cash per share (comprising a scheme amount per share of \$0.96 to be paid by QIC Bidco and a final \$0.015 per share fully-franked dividend intended to be paid by Pacific Energy). The QIC SID detailed circumstances under which a break fee of \$4.1 million (approximately 0.98% of the aggregate implied equity value of Pacific Energy under the proposed scheme) may be payable by Pacific Energy.
5. On 28 August 2019, the Consortium sent a confidential letter to Pacific Energy stating that it expected to be in a position to submit a proposal that would constitute a “Target Superior Proposal” as defined in the QIC SID. The letter stated that the Consortium required, if it submitted its proposal and as a result of a counter-proposal the Consortium was unsuccessful in acquiring Pacific Energy, Pacific Energy to pay the Consortium a break fee of \$4.1 million.
6. On 29 August 2019, Pacific Energy responded stating that because the Consortium’s letter did not include a price it would not be considered a bona fide “Target Competing Proposal” under the QIC SID and Pacific Energy would not take any action in respect of the letter. A copy of the response was forwarded to QIC Bidco’s solicitors. QIC Bidco’s solicitors in reply stated that any agreement to pay a break fee in the circumstances contemplated in the Consortium’s letter would be a breach of the QIC SID and payment of the break fee would constitute unacceptable circumstances.
7. On 7 September 2019, the Consortium sent another letter to Pacific Energy indicating that any definitive proposal would be no less than \$1.085 cash per share (comprising a scheme amount per share of \$1.070 plus an assumed \$0.015 per share dividend) and stated that *“to assist you overcome any unease associated with agreeing a break fee in the absence of knowing precisely the price we are prepared to offer under our Definitive Proposal, we are prepared to accept a break fee of A\$2.5m”*.
8. On 9 September 2019, the Consortium sent a definitive proposal letter to Pacific Energy to acquire 100% of Pacific Energy shares for \$1.085 cash per share (comprising a scheme amount per share of \$1.070 plus an assumed \$0.015 per share

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dividend) to be implemented by way of a scheme of arrangement. The offer represented a premium of approximately 11% to the QIC Bidco offer price. The letter attached a proposal deed and a suite of scheme documents (including the APC SID) executed by APC Bidco to be held in escrow pending execution of the proposal deed by Pacific Energy by 8:00am on 10 September 2019.¹ The proposal deed provided that Pacific Energy must pay APC Bidco a break fee of \$2.5 million if Pacific Energy did not execute the APC SID by 12 noon on 17 September 2019, payable within five Business Days (as defined in the proposal deed) after such deadline.

9. On 10 September 2019, Pacific Energy announced that it had received the competing proposal, the Pacific Energy board considered that the competing proposal was a “Target Superior Proposal” (as defined in the QIC SID) and Pacific Energy had notified QIC Bidco and commenced the matching right process under the QIC SID. It also disclosed that Pacific Energy had entered into the APC Proposal Deed and described the Consortium Break Fee.
10. On 12 September 2019, QIC Bidco sent a letter to Pacific Energy alleging breaches by Pacific Energy of the QIC SID and reserving all its rights.
11. On 13 September 2019, QIC Bidco exercised its matching rights under the QIC SID by sending Pacific Energy a revised offer increasing the scheme amount per share to \$1.070 with a further conditional \$0.005 per share if Pacific Energy did not pay the Consortium Break Fee. QIC Bidco also provided for an increase in its break fee from \$4.1 million to \$4.7 million given the increase in consideration.
12. On 16 September 2019, after QIC Bidco made its application to the Panel, Pacific Energy announced that it had entered into a deed of variation in respect of the QIC SID and the Pacific Energy board recommended that all Pacific Energy shareholders vote in favour of the revised QIC Bidco offer (in the absence of a superior proposal and subject to the independent expert concluding that the revised QIC Bidco offer is in the best interests of Pacific Energy shareholders). Accordingly the Consortium Break Fee had been triggered.

APPLICATION

Declaration sought

13. By application dated 13 September 2019, QIC Bidco sought a declaration of unacceptable circumstances. QIC Bidco submitted that:
 - (a) since at least 28 August 2019, the Consortium had engaged with Pacific Energy with the clear intention of inducing Pacific Energy to breach the QIC SID
 - (b) entry into the APC Proposal Deed:
 - (i) constituted a wilful breach of the QIC SID by Pacific Energy

¹ All deadlines under the APC Proposal Deed were specified as Perth time

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- (ii) was inconsistent with Pacific Energy's publicly disclosed intentions in the QIC SID with respect to how it would conduct its affairs with respect to QIC Bidco's proposal and any competing proposal and
- (iii) reduced the value of the assets of Pacific Energy by the amount of the Consortium Break Fee.

14. QIC Bidco submitted that these circumstances had hindered, or were likely to hinder, the acquisition of control of Pacific Energy taking place in an efficient, competitive and informed market.

Interim orders sought

15. QIC Bidco sought interim orders to the effect that the Panel suspend the operation of the APC Proposal Deed, Pacific Energy and APC Bidco be restrained from entering into the APC SID and that Pacific Energy be restrained from paying the Consortium Break Fee to APC Bidco, each pending the determination of the application.
16. The Consortium offered, and the Panel accepted in lieu of making an interim order, an undertaking from the Consortium to forbear on a demand for the payment of the Consortium Break Fee pending the outcome of these proceedings.

Final orders sought

17. QIC Bidco sought final orders including to the effect that the APC Proposal Deed be cancelled and APC Bidco be restrained from enforcing any rights against Pacific Energy contemplated by the APC Proposal Deed.

DISCUSSION

18. On the one hand, we considered that Pacific Energy's directors had obtained a superior outcome for shareholders and there was little that prompted us to second guess the board of Pacific Energy.² On the other hand, in our experience, the Consortium's approach in requiring Pacific Energy to sign up to the APC Proposal Deed (including payment of the Consortium Break Fee if the APC SID was not signed by the 12 noon, 17 September deadline) was not a common market approach. Therefore we decided to conduct proceedings and make limited enquiries.
19. The submissions discussed below raised a number of policy issues which we consider are useful to discuss.

Entry into the APC Proposal Deed

20. QIC Bidco submitted that entry into the APC Proposal Deed breached:
- (a) clause 12.10 of the QIC SID which prohibited Pacific Energy from entering into any agreement, commitment, arrangement or understanding relating to a "Target Competing Proposal" (other than a confidentiality agreement) until QIC Bidco had exhausted its matching rights under the QIC SID and

² The Panel having come to a similar view and declining to conduct proceedings in *GBST Holdings Limited* [2019] ATP 15 at [36]

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- (b) clause 6.1.3 of the QIC SID which required Pacific Energy to ensure that all assets are maintained in the normal course of business consistent with past practice.
21. QIC Bidco submitted that the Consortium was fully aware of the terms of the QIC SID, yet knowingly structured its proposal so as to require the entry into the APC Proposal Deed in breach of the QIC SID.
22. Pacific Energy and the Consortium both submitted that the legal rights and obligations of the parties under the QIC SID were properly within the jurisdiction of the courts and the Panel was not the appropriate forum for the enforcement of those obligations.
23. QIC Bidco submitted that it was not the fact of the breaches of the QIC SID, but rather, the effect that those had on the auction for control that was important (noting that not all breaches of an implementation agreement would necessarily involve unacceptable circumstances).
24. We consider the matters raised in the application are properly before us and it is appropriate for us to examine the effect or likely effect of all the circumstances having regard to the principles set out in sections 602 and 657A.³ Whether the Panel should opine on whether there has been a breach of a scheme or bid implementation agreement if that has been alleged depends on the specific facts. In this case, we do not find it necessary to do so.
25. QIC Bidco submitted that Pacific Energy's wilful breach of clause 12.10 of the QIC SID denied QIC Bidco the benefit of its matching right. QIC Bidco submitted that there would be a significant adverse effect on competition for control if potential bidders cannot rely on their matching rights and other protections which are fundamental to their decision to participate in an auction for control, stating:
- The significance of the matching right to QIC Bidco is not unique to QIC Bidco's offer for Pacific Energy. Most (if not all) bidders participating in an auction for control place equivalent importance on the matching right and similar protections. In this sense those provisions are critical to facilitating a competitive auction. The Panel has acknowledged this in previous decisions.⁴*
26. It further submitted that *"participants in an efficient, competitive and informed market should be entitled to make significant investment decisions, expend funds and otherwise conduct their affairs on the basis that contractual obligations will be performed"*, noting that the QIC SID was a public document.
27. The Consortium submitted that the application *"misconceives"* that the lock-up devices in the QIC SID *"fall within some form of Panel safe harbour and therefore should be policed and enforced by the Panel"* and *"assumes that the Panel's tolerance of deal protection regimes amounts to positive reinforcement of those regimes, when in fact the principles in s 602 are weighted primarily towards contestability"*. It further submitted that any

³ Unless otherwise indicated, all statutory references are to the *Corporations Act 2001* (Cth), and all terms used in Chapter 6 or 6C have the meaning given in the relevant Chapter (as modified by ASIC)

⁴ Quoting *Ross Human Directions Limited* [2010] ATP 8 at [26] and *GBST Holding Limited* [2019] ATP 15 at [35]

finding that the public release of a scheme implementation agreement is a representation that the target will comply with its terms is likely to lead to decreased competition and ignores the sole remedy (i.e. liquidated damages) and break fee provisions in such agreements.

28. There is nothing in our view that gives a bidder's matching right any special place in the market for control beyond its contractual terms.⁵ A bidder can decide not to match a competing proposal or seek to terminate its agreement if there is a breach of the agreement by the target and receive its break fee from the target. As noted by Pacific Energy, Pacific Energy kept QIC Bidco informed of its contact from the Consortium and QIC Bidco had "*the ability to terminate the QIC SID and collect the break fee to cover its costs*".
29. ASIC submitted that we should not incentivise multiple bidders entering proposal deeds each with break fees because to do so would "*erode the value of winning the initial competitive auction and entering a scheme implementation agreement*". The parties did not agree as to whether there was an initial competitive auction in this case. We do not consider it necessary to reach a conclusion on this issue.
30. QIC Bidco made a similar submission to ASIC stating that we should prevent conduct that has a dampening effect on bidders' willingness to put forward scheme proposals. In reply, the Consortium submitted that the concern around dampening effects applies equally to counterbidders' willingness to put forward superior competing proposals. It submitted that an efficient and competitive market would not be enhanced by favouring QIC Bidco's restrictive lock-up regime. The Consortium submitted that the lock-up devices in the QIC SID had an anti-competitive effect because there was no 'fiduciary out' applicable to the notification obligations⁶ or any part of the matching right obligations.
31. Pacific Energy submitted that it did not consider that the QIC SID unduly fettered Pacific Energy in relation to competing proposals so long as it was able to rely on its contractual agreements, in particular the limitation on liability of Pacific Energy (including in respect of any breach of the QIC SID) being equal to the break fee payable to QIC Bidco. It submitted that the limitation on liability allowed its directors to assess the competing proposal "*whilst understanding what the fixed quantum of potential damages may be for any chosen course of action*". Pacific Energy submitted that it was imperative that at all times it had a binding scheme implementation deed on foot and accordingly, if QIC Bidco did not exercise its matching right, then Pacific Energy could unilaterally accept the Consortium's proposal which would be binding on the Consortium.
32. Pacific Energy submitted that after receiving advice from its legal advisers, Senior Counsel and financial advisers:

⁵ In our view the statements in *Ross Human Directions Limited* [2010] ATP 8 at [26] and *GBST Holdings Limited* [2019] ATP 15 at [35] do not go as far to say that matching rights and similar protections are "*critical to facilitating a competitive auction*"

⁶ Referring to Guidance Note 7 at [15] and [21(b)] and *Ross Human Directions Ltd* [2010] ATP 8 at [28]

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“...the Pacific Energy directors were satisfied that, notwithstanding the requirement to potentially pay the Consortium Break Fee, the Consortium Proposal was in the best interests of the Pacific Energy shareholders due to the significant uplift in the offer price and securing an unilaterally executable transaction. Further, the Pacific Energy directors were of the view that the Consortium Break Fee did not create an anti-competitive environment. The Pacific Energy directors were guided by their fiduciary duties to act in the best interest of Pacific Energy shareholders in securing a higher offer.”

33. In substance we do not consider the Consortium Break Fee to be anti-competitive or coercive. Both Pacific Energy and the Consortium submitted that, without the Consortium Break Fee, the Consortium would not have provided a binding proposal at an uplift of 11% to the existing offer price. In our view, the terms of QIC Bidco’s matching right forced Pacific Energy to accept the Consortium Break Fee in order to secure a fully executed deal at the higher price. Pacific Energy was at all times transparent with QIC Bidco and in substance preserved QIC Bidco’s matching right. QIC Bidco was not denied the benefit of its matching right; it received and exercised its matching right and secured an increase in the amount of its break fee.
34. Considering the effect or likely effect of a lock-up device requires us to weigh how the lock-up device may help secure a proposal or deter a proposal.⁷ This requires us to consider (among other things) *“the potential benefits to target shareholders of the agreement and the reasons why target directors are satisfied of the commercial and competitive benefits to shareholders of entering the agreement”*.⁸ This will depend on the facts of each case. Here, as a result of entering into the APC Proposal Deed, Pacific Energy facilitated a rival proposal leading to a materially higher offer. This delivered significant additional value to Pacific Energy shareholders. Accordingly, in our view, the actions of the Pacific Energy board did not inhibit the acquisition of control taking place in an efficient, competitive and informed market or deny shareholders an opportunity to participate in the benefits of a proposal.

Reduction in the value of the assets of Pacific Energy

35. QIC Bidco submitted that the Consortium’s proposal was designed to frustrate QIC Bidco’s matching right because if QIC Bidco exercised its matching right it acquired Pacific Energy with reduced assets, or in other words, *“it must pay more for less”*. It submitted that this cost would be borne by Pacific Energy shareholders through a lower counter proposal from QIC Bidco (or another bidder) and/or QIC Bidco.
36. We consider that a break fee may impact the price that a competing bidder is willing to pay and may deter a competing bidder. However, we disagree that the cost of the Consortium Break Fee is borne by Pacific Energy’s shareholders or that they are otherwise harmed by the Consortium’s offer. To the contrary, the Consortium’s offer has increased the value that Pacific Energy shareholders will receive by approximately 11%.

⁷ Guidance Note 7 at [7]

⁸ Guidance Note 7 at [18]

Trigger for payment of the Consortium Break Fee

37. We asked parties whether the trigger for payment of the Consortium Break Fee under the APC Proposal Deed was unacceptable or unreasonable. The Consortium submitted that there was no other logical point at which the Consortium Break Fee could be triggered in order to achieve the commercial outcome sought. It submitted that the structure of the break fee trigger in the APC Proposal Deed was effectively analogous to the clause in the QIC SID where the target board's support of a competing proposal gave rise to an immediate right to a \$4.1m break fee.
38. ASIC submitted that the trigger was "*fundamentally different*" to that of the QIC SID. It submitted that the trigger, being the non-entry into the APC SID within one week, was effectively a proxy for QIC Bidco matching the Consortium's offer. It submitted that the break fee in the QIC SID is triggered if Pacific Energy departs from the agreed process prior to implementation of the scheme. By contrast, it submitted that, in the case of APC Bidco, there was no binding implementation agreement for Pacific Energy to break.
39. We do not consider the Consortium's request for the Consortium Break Fee to be unreasonable or unacceptable. In the circumstances of this matter, the trigger in the APC Proposal Deed was in substance equivalent to the trigger in the QIC SID that QIC Bidco would have relied on if it had not matched the Consortium's offer. Here, the Consortium was able to negotiate the break fee because it had previously undertaken extensive due diligence and as a result was able to provide an unconditional, legally binding offer. Pacific Energy's arrangements with the Consortium allowed it to preserve the substance of QIC Bidco's matching right without losing the superior proposal.

Fetter on Pacific Energy's actions

40. ASIC submitted that "*[m]arket practice is generally for rival offers to be made without the imposition of a break fee on the proposal – leaving target directors free to consider the proposal on its merits*". It submitted that the net effect of several circumstances in relation to the APC Proposal Deed unduly fettered the actions of Pacific Energy:
- (a) the Consortium's offer or the APC SID would not have been provided if the APC Proposal Deed had not been executed
 - (b) the requirement that the APC Proposal Deed be executed less than one day after the offer letter and relevant documents were provided by the Consortium
 - (c) the notification and matching right obligations under the QIC SID could only occur after the APC Proposal Deed was executed.
41. ASIC also submitted that the Consortium's proposal placed Pacific Energy in a position during a control transaction where it assumed all the risk, whereas the prospective bidder could only benefit (by receiving \$2.5 million if QIC Bidco matched or securing the APC SID if QIC Bidco did not match).
42. We do not consider that the Pacific Energy board was unduly pressured to consider the Consortium's proposal. The materials and submissions show that the proposal developed through a series of correspondence and that the Pacific Energy directors

had adequate time to consider the proposal and obtain advice in all the circumstances. The Pacific Energy directors, after considering their contractual obligations under the QIC SID (among other things), determined that the structure of the APC Proposal Deed afforded Pacific Energy deal certainty in respect of a superior proposal.⁹ Based on our experience, we consider the risk predominantly fell on the Consortium which invested time, effort and cost (including in relation to arranging financing) in submitting a competing proposal that would stay open for seven days (provided the APC Proposal Deed was executed by Pacific Energy), but unlike QIC Bidco, did not have the benefit of any notification or matching rights if its proposal was matched by QIC Bidco and would not have had any of its costs reimbursed if Pacific Energy elected not to execute the APC Proposal Deed.

Aggregation of break fees

43. ASIC further submitted that the uplifted QIC Bidco break fee and the Consortium Break Fee should be aggregated for the purposes of the 1% guideline¹⁰ because any third bidder that made a successful offer for Pacific Energy would be liable to pay both fees. It also submitted that the cumulative effect of the uplifted QIC Bidco break fee and the Consortium Break Fee was such that Pacific Energy shareholders may feel coerced into voting for the revised QIC Bidco offer to avoid the additional deterioration of value of Pacific Energy.
44. Currently, the only fee payable is the Consortium Break Fee (representing 0.54% of the equity value of Pacific Energy). We do not see any need at this time to consider the likely effect of the “aggregated fee” on a hypothetical third bidder. In addition, as submitted by Pacific Energy, there is currently no circumstance in which the “aggregated fee” should be a relevant consideration to Pacific Energy shareholders to approve the QIC Bidco scheme because the uplifted QIC Bidco break fee is not payable where Pacific Energy shareholders do not approve the scheme.
45. The Consortium submitted that if aggregate break fees were capped at 1%, as a practical consequence, the initial bidder will always be able to demand a higher break fee than a subsequent superior bidder who can only impose a break fee that is referable to the amount of the increased offer. It submitted that this would discourage competition. It also submitted that Guidance Note 7 only aggregates fees for purposes of the 1% guideline when they are payable by a party and its associates in respect of the same or related transactions.¹¹
46. Again, we do not need to consider a hypothetical cap of 1% on aggregate break fees. However, generally speaking, in the case of two competing bidders and where a transaction is implemented, only one break fee would ultimately be payable at the end of any auction to the out-bid bidder and (assuming the 1% guideline is adhered to) that break fee will be equal to 1% of the out-bid bidder’s last offer. More than one break fee may become payable if there are more than two competing bidders. Whether this would be unacceptable however, would turn on the facts of the case

⁹ See paragraphs 31 and 32

¹⁰ GN 7 at [9]

¹¹ GN 7 at [11]

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including the extent to which the overall bid consideration to shareholders had increased as a result of competing bids by multiple parties.

DECISION

47. For the reasons above, we declined to make a declaration of unacceptable circumstances. We consider that it is not against the public interest to decline to make a declaration and we had regard to the matters in s657A(3).

Orders

48. Given that we made no declaration of unacceptable circumstances, we make no final orders, including as to costs.

Ron Malek

President of the sitting Panel

Decision dated 24 September 2019

Reasons given to parties 22 October 2019

Reasons published 25 October 2019

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Advisers

Party	Advisers
QIC Bidco	Allens
Pacific Energy	DLA Piper Australia
Consortium	King & Wood Mallesons