

# TAKEOVERS IN AUSTRALIA **GUIDE**



This guide provides an overview of the regulatory landscape and key considerations involved in acquiring control of an Australian publicly listed or widely held entity.

Acquisitions of controlling interests in Australian publicly listed or widely held entities are highly regulated and complex, and involve different issues depending on the nature of the proposed target, the sector in which the target operates and the characteristics of the bidder.

A carefully considered deal strategy is critical. The strategy will often include engagement at an early stage with Government and key stakeholders.

This guide contains general information only and is not legal advice. Please contact us if you require specific legal advice.

## OUTLINE OF THIS GUIDE

This guide consists of the following parts:

- **1** – Introduction
- **2** – Executing a takeover bid – the bidder
- **3** – Responding to a takeover bid – the target
- **4** – Differences – takeover bid and scheme of arrangement
- **5** – Indicative timeline – takeover bid and scheme of arrangement
- **6** – Executing a scheme of arrangement
- **7** – Target’s long term preparation for a bid or scheme of arrangement
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# I. INTRODUCTION

In Australia, there is a general prohibition on acquiring more than a 20% holding<sup>1</sup> of voting securities in a listed or widely held entity<sup>2</sup>, unless one of several permitted transaction structures is used.

The two most common transaction structures used in Australia to acquire control of a listed or widely-held entity are a 'takeover bid' and a 'scheme of arrangement'<sup>3</sup>.

Alongside detailed and specific regulation of control transactions, Australia applies certain policies to protect holders of target securities and to facilitate an efficient market for control<sup>4</sup>.

## Takeover bid

Under a takeover bid, an individual offer is made to every holder of voting securities in the target. All the offers must be on the same terms. Each target holder of securities can accept the offer, or do nothing.

A takeover offer can be made off-market<sup>5</sup> or on-market<sup>6</sup>. An off-market bid can be subject to a minimum acceptance condition. A 50.1% or 90% minimum acceptance condition is most common.

If the bidder acquires more than 50% it can determine who is elected as a director of the target, and if it reaches a holding of 90% or more of all bid class securities, it can compulsorily acquire the outstanding securities<sup>7</sup>.

## Scheme of arrangement

A scheme of arrangement is a Court supervised acquisition pursuant to a shareholder vote. The bidder enters into a 'scheme implementation agreement' with the target company. A scheme is usually a proposal to acquire all shares in the target company. The proposal can be conditional or unconditional, for cash, for scrip, or for cash and scrip.

The target seeks Court approval to convene a meeting of its voting security holders. If at least 75% of the shares voted (excluding securities held by the bidder) and 50% of

the shareholders who vote<sup>8</sup>, are in favour of the scheme, the Court orders that all the shares are transferred to the bidder on payment by the bidder.

Because a scheme of arrangement transaction is run principally by the target company, a scheme cannot be used for a hostile bid. In contrast, a takeover bid can be friendly (meaning recommended by the target's board) or hostile (meaning that it is not initially supported by the target's board).

## Target's response

Target entities are restricted in Australia in the defensive strategies available to them in response to a hostile or unsolicited bid. Poison pills are generally not able to be used.

The target is likely to focus on the adequacy of the price offered and any unusual conditions or characteristics of the bid or bidder. If the bid price includes non-cash value (such as shares in the bidder), the target's focus will include an assessment of the value of the non-cash component.

## Regulators

The principal regulators involved in takeovers in Australia are the Takeovers Panel and the Australian Securities & Investments Commission (**ASIC**). In the case of schemes of arrangement, the Federal Court or a State Supreme Court will have an important role. When the bidder is foreign or has substantial foreign shareholders, the approval of the Foreign Investment Review Board (**FIRB**) may also be required.

## Threshold issues for bidder

Threshold legal issues for a bid will usually include tax and structure, competition, due diligence and, often, foreign investment approval. Other threshold issues will include bid funding, any engagement with the target board or strategic holders of securities in the target, whether the bidder should acquire a pre-bid stake in the target, whether the target will limit its freedom to deal with other bidders, and general bid strategy and tactics.

<sup>1</sup> Technically, acquisitions of 'relevant interests' resulting in changes of 'voting power' are regulated. Holdings of 'associates' are relevant.

<sup>2</sup> Generally, Australian entities which are listed or which have more than 50 holders of voting securities are subject to Australia's takeover laws. 'Entities' in this context includes companies incorporated in Australia and listed managed investment schemes.

<sup>3</sup> A takeover bid can be used where the target entity is an Australian company or a listed managed investment scheme (most commonly, a unit trust). A 'scheme of arrangement' can only, broadly, be used where the target is an Australian company. A 'trust scheme', described later in this booklet, can be used to acquire all the units in a unit trust.

<sup>4</sup> These policies are set out in s 602 of the *Corporations Act*, and are applied in particular by the Takeovers Panel and the Australian Securities & Investments Commission.

<sup>5</sup> Meaning that the offer is not made through the stock market – it may be conditional, and can be for cash or scrip, or both.

<sup>6</sup> Meaning that it is made through the market platform of a securities exchange, is unconditional, and for cash only.

<sup>7</sup> The bidder must also acquire at least 75% of the shares that the bidder offered to acquire under the bid.

<sup>8</sup> This second test is often referred to as the 'headcount' test, because it counts the number of shareholders, not the number of shares.

## 2. EXECUTING A TAKEOVER BID – THE BIDDER

### **Pre-bid stake**

One of the first questions that a bidder faces in executing a bid is whether it should acquire shares in the target before the bid. Issues relevant to this decision include:

- a stake of 10% or more will prevent any subsequent bidder from reaching the 90% threshold at which the subsequent bidder can compulsorily acquire the remaining shares. This gives the bidder with the 10%+ stake a tactical advantage;
- the highest price paid by the bidder or its associates for shares in the target in the four months before a bid is the minimum price at which the bid can be made;
- whether significant lines of stock are available from major shareholders or through the securities exchange. Seeking to acquire shares from major shareholders risks the loss of the confidentiality of the proposed bid;
- sellers of shares pre-bid may insist on receiving any increases to the bid price, and may insist on being free to sell to a higher bidder;
- if the bid will be conditional and the conditions are ultimately not satisfied, the bidder will not have to pay for shares accepted into the bid. It will, however, have to pay for shares acquired pre-bid; and
- the need to disclose, within two business days, holdings in the target above 5%, and then to disclose acquisitions in 1% increments.

### **Engaging with the target's board**

#### **Seeking a recommendation**

Retail shareholders in the target are influenced by whether the directors of the target recommend a bid. Recommended bids are therefore more likely to succeed than bids which are not recommended.

Most bidders would therefore like to have the target's directors' recommendation. For the bidder, the downside in seeking their recommendation is that the directors are

likely to seek to maximise the bid price. This may make it difficult for the bid to be recommended at a price that is highly favourable to the bidder.

Many bids that initially do not have the target's directors' recommendation receive that recommendation after a process of negotiation during the bid period.

#### **Seeking due diligence**

Some bidders are prepared to proceed with a bid relying on publicly disclosed information about the target. Many bidders and their debt financiers, however, require an opportunity to undertake at least some due diligence investigations of the target. These investigations may seek to test key disclosures by the target, and may focus on some risk areas which are important to the prospects of the target.

Due diligence using materials which are not publicly available requires the consent of the target company. As with seeking a target's directors' recommendation, seeking that consent gives the directors an opportunity to negotiate the bid price, as the directors will not allow access for due diligence at a bid price which they are not prepared to recommend.

#### **Announcing the bid**

A person who publicly proposes a bid must proceed with the bid within two months, on terms no less favourable to the holders of bid class securities than those announced in the public proposal. Obviously, great care needs to be taken in drafting any announcement of a proposed bid. All expected conditions to the bid should be included in the announcement.

In addition to the two month rule, prospective bidders should be aware of the 'truth in takeovers' policy of ASIC. If the bidder states publicly that it will do or will not do something in relation to its bid, ASIC is likely to hold the bidder to that statement<sup>9</sup>.

<sup>9</sup> Specific applications of this policy are set out in ASIC's Regulatory Guide 25 *Takeovers: false and misleading statements*.

## Funding

When a bidder announces its bid, it must have a reasonable basis to expect that it will have funding in place to complete its bid. To the extent that the bidder will depend on a new debt facility to complete the bid, it should have at least a binding debt commitment letter before announcing its bid, and preferably have fully documented its debt facilities before offers are sent to the holders of bid class securities.

### The bidder's statement

The individual offers sent to every holder of securities in the bid class are contained in a 'bidder's statement', which also contains disclosures about matters including:

- the bidder's intentions for the target, after the bid;
- the bidder's funding arrangements for the bid;
- if the bid price includes an offer of securities, Australian prospectus level disclosure in relation to those securities; and
- any other information that is known to the target and is material to a decision whether to accept the offer.

### Price: minimum price, collateral benefits

The highest price paid by the bidder or its associates for shares in the target in the four months before a bid is the minimum price at which the bid can be made.

It is likely to be unacceptable under the Takeovers Panel's policy for a bidder to provide a holder of target shares something of value which it does not offer to other holders of bid class securities<sup>10</sup>. Such a benefit is expressly prohibited during the offer period for a bid.

### Disclosure of funding

A bidder must disclose in its bidder's statement how it will fund its bid. This may require disclosure of the identity of any lender, the amount available for drawdown, any material conditions precedent to drawdown and the basis on which the bidder believes it will be able to satisfy the conditions to drawdown.

## Conditions

An off-market bid can be subject to conditions. Common conditions include:

- any required regulatory approval conditions. These commonly include a FIRB approval condition (if the bidder is foreign), and may include an Australian Competition and Consumer Commission (**ACCC**) approval condition (if the bid may have the effect of substantially lessening competition in a market in Australia);
- a 50.1% or 90% minimum acceptance condition;
- a condition that there is no adverse change to the target's capital structure, constitutional or other corporate arrangements<sup>11</sup>; and
- a material adverse change or 'market fall'<sup>12</sup> condition.

Certain conditions are prohibited, including a maximum acceptance condition<sup>13</sup>, and a condition the satisfaction of which is controlled by the bidder or its associates.

### Other key documents

Apart from the bidder's statement, key documents for the bidder may include the following.

#### Pre-bid stake agreement

The bidder may acquire a pre-bid stake by on-market or other purchase. It is not uncommon, however, for any stake to be acquired under a contingent agreement.

Sometimes the acquisition is structured as a call option, under which the bidder can call for the shares. The option may give the holder the opportunity to accept into the bid rather than delivering its shares under the option.

Commonly, the holder will agree to accept into the bid. Such an agreement will usually be contingent on there being no competing offer for the target at a price higher than the bidder's offer price.

Sometimes synthetic pre-bid stakes are acquired, through the use of derivatives such as cash settled equity swaps. The obligation on the bidder to disclose, within two business days, holdings in the target above 5% does not strictly apply to synthetic stakes. However, it is the policy of the Takeovers Panel that synthetic interests should be disclosed in the context of a control transaction<sup>14</sup>.

<sup>10</sup> Takeovers Panel Guidance Note 20: *Collateral Benefits*.

<sup>11</sup> This condition usually includes the matters listed in section 652C of the *Corporations Act 2001*.

<sup>12</sup> Typically, a condition that a specified equity market index not fall by more than a specified percentage from the level it was at when the bid was announced.

<sup>13</sup> Maximum acceptance conditions are prohibited because they are considered coercive to the holders of securities in the target. A takeover bid can, however, be made for a specified proportion of each holding.

<sup>14</sup> Takeovers Panel Guidance Note 20: *Equity Derivatives*.

## Confidentiality agreement

Before the bidder will be allowed access to the target's information for the purpose of conducting due diligence, the target will generally require the bidder to execute a confidentiality agreement.

These agreements often have other terms which restrict the bidder, such as a requirement not to acquire any shares in the target, or not to make a bid which is not recommended by the target's directors. These other terms can have important consequences for the bidder's deal strategy.

## Implementation agreement

If the target's directors will recommend the bid, the target will facilitate the bid. The target and the bidder will then commonly enter into a 'bid implementation agreement', in which they agree that the bid will be launched and how they will co-operate to facilitate the bid.

The bidder will want the implementation agreement to contain 'deal protection' measures, such as 'no-shop', 'no-talk' and 'no due diligence' restrictions, discussed

further below. The bidder will also want an agreement for the target to pay a break fee if a competing proposal is successful. A break fee of up to 1% of the equity value of the target is common, because the Takeovers Panel has issued guidance which indicates that it will usually not regard a break fee of that size as coercive to target shareholders or likely to thwart competition for control of the target<sup>15</sup>.

## Compulsory acquisition

If the bidder:

- reaches a holding of 90% or more of all bid class securities; and
- acquires at least 75% of the securities that the bidder offered to acquire under the bid,

the bidder can initiate a procedure to compulsorily acquire all outstanding bid class securities at the bid price. Holders of bid class securities which are subject to compulsory acquisition have limited objection rights.

<sup>15</sup> Takeovers Panel Guidance Note 7: *Lock-up devices*. Being coercive of target shareholders or thwarting competition for control would breach the policies set out in s 602 Corporations Act.



# 3. RESPONDING TO A TAKEOVER BID – THE TARGET

## Recommend or not?

### Price and conditionality

If a target receives a takeover bid, each director of the target is required to recommend that ‘offers under the bid be accepted or not accepted’<sup>16</sup>.

Most bids are initiated with the bidder approaching the target board with a proposal to bid, which may be subject to:

- the prospective bidder being given an opportunity to conduct due diligence; and
- the proposed bid being recommended by the target’s directors.

In both cases the target’s directors will focus in particular on the offer price and any conditions to the offer.

Target directors often seek advice from a financial adviser or independent expert<sup>17</sup> as to the adequacy of the offer price. Successful takeovers commonly occur at approximately a 30% premium to the ‘undisturbed’ share price<sup>18</sup> of the target. The size of the premium varies, though, in different market conditions, and with targets in different sectors and which have different investment characteristics.

Under Australian law, it is not necessary for the directors to test the market before recommending a bid. Their recommendation does not prevent an overbid from being made by another bidder.

As part of their assessment, the target’s directors will consider whether any bid or proposal is excessively conditional. Excessive conditions could make it uncertain whether the bid is likely to be successfully executed. This is especially true of any unusual conditions in a bid proposal, the satisfaction of which is within the control of the bidder<sup>19</sup>.

### Exclusivity and access for due diligence

If a prospective bidder approaches the target seeking an opportunity for due diligence or a recommendation by the target’s directors, the prospective bidder is likely to also seek exclusivity – that is, a commitment from the target that the target will not deal with any other prospective bidder for a specified period.

Any such opportunity and commitment should only be given if the target’s directors are satisfied that the proposal is in the best interests of the target company. In the typical case of a bid for the ordinary shares in the target, this means that the target’s directors must be satisfied that the bid is in the best interests of the ordinary shareholders of the target.

If the target’s directors are likely to be prepared to recommend a proposed bid, they are likely to consider that it is appropriate for them to commit to exclusivity.

Even then, the commitment should only be given subject to ‘fiduciary outs’. These are qualifications which enable the target to breach exclusivity if the target receives a proposal which is superior to the exclusivity proposal. In those circumstances, the target’s directors’ fiduciary duties require them to evaluate the superior proposal (because doing so is acting in the best interests of the holders of bid class securities).

### Deal protection

Conducting due diligence and pursuing its proposal will require the bidder to commit executive resources and incur advisors’ fees. Its exclusivity protection is likely to be qualified by ‘fiduciary outs’, as mentioned above. It is likely to ask the target for other provisions to protect its position.

<sup>16</sup> Section 638(3) *Corporations Act 2001*.

<sup>17</sup> A financial adviser provides general advice on how to respond to a bid, including on value, tactics and strategy. An independent expert provides a formal opinion on whether the bid price is adequate for the purposes of a change of control transaction. In some circumstances, the target is required to obtain an independent expert’s report and include the report with its target’s statement, which is sent to all holders of bid class securities. In other cases, the target’s directors may choose to obtain such a report, even if they are not required to do so.

<sup>18</sup> Meaning the share price before news of the takeover bid pushed the target’s share price higher.

<sup>19</sup> As noted, conditions of this type are prohibited in bids. They may, however, be included in proposals to the target’s board.



Most commonly, to bolster its exclusivity, the bidder will ask the target for the following:

- a no-shop restriction, preventing the target from soliciting alternative proposals. Usually, this restriction is not subject to a fiduciary out, because the target's directors fiduciary duties are unlikely, in Australia, to require them to shop for a superior proposal;
- a no-due-diligence restriction, preventing the target from passing information to a potential competing bidder as part of due diligence without the consent of the original bidder. This should be subject to a fiduciary out; and
- a no-talk restriction, preventing the target negotiating with any potential competing bidder. This should be subject to a fiduciary out.

### **Bidder's ability to fund**

When considering whether to recommend a bid or engage with a bidder which is proposing a change of control transaction, the target's directors will need to be satisfied that the bidder has the capacity to execute the bid or proposal, including to fund the offer price. The target's directors may require evidence of the availability of bidder group cash or funding lines, or of the likely availability of debt funding, before recommending a bid or engaging constructively with a prospective bidder.

### **Independent expert's report**

The target may commission a report from an independent expert on the adequacy of a bid in three different circumstances, described below. The independent expert will be an expert on corporate valuation, and will hold a licence under the Australian financial services licence regime.

- If the bidder holds more than 30% of the shares in the target, or the bidder and target have one or more directors in common, the target must include in the target's statement an independent expert's report on whether the bid is 'fair and reasonable' to target shareholders<sup>20</sup>.
- Even though they are not legally required to do so, the target's directors may wish to include in the target's statement an independent expert's report on whether the bid is 'fair and reasonable'.
- The target's directors may wish to obtain such a report to assist them in evaluating the bid, even though they are not legally required to obtain the

report and the directors do not propose to send the report to the holders of bid class securities. However, the fact that the directors have obtained such a report, and the conclusions of the report, may be information that should be disclosed in the target's statement as information that the holders of bid class securities would reasonably require to make an informed assessment of the bid<sup>21</sup>. The target's directors might then consider that the expert's reasoning and analysis would also be relevant to the holders of bid class securities, so that they should include any such report with the target's statement.

### **Target's statement**

The target's formal response to the bidder's statement is called the 'target's statement'. It must include:

- all the information that the holders of bid class securities and their professional advisers would reasonably require to make an informed assessment whether to accept the takeover offer. This will usually include information on the adequacy of the bid price and, if the target's directors are not recommending the bid, arguments and information rebutting the bidder's principal arguments; and
- a statement by each director of the target recommending that offers under the bid be accepted or not accepted, and giving reasons<sup>22</sup>.

The target must send the target's statement to the holders of bid class securities (and the bidder, ASX and ASIC) within 15 days after the target receives notice that the bidder has sent its bidder's statement to the holders of bid class securities.

### **Applying to the Takeovers Panel**

If the target considers that the bidder has contravened the law or has acted inconsistently with the purposes of the takeover provisions, it may apply to the Takeovers Panel, seeking a declaration of 'unacceptable circumstances'.

The Takeovers Panel is an administrative tribunal and not a court. Its procedures are less rigorous than a court's, and it makes determinations more quickly than a court.

The Takeovers Panel is amenable to any curable defects in the bidder's conduct being addressed by remedial actions by, or undertakings from, the bidder. It follows

<sup>20</sup> Section 640 *Corporations Act 2001*.

<sup>21</sup> Section 638(1) *Corporations Act 2001*.

<sup>22</sup> Section 638 *Corporations Act 2001*.



that purely tactical applications to the Takeovers Panel as part of a defence strategy of delaying the bidder are not common.

### Seeking superior proposals

If a bidder proceeds without a recommendation and the target's directors consider that the bid may succeed, the target (through its financial adviser) is likely to test the market for a superior proposal, by contacting potential overbidders and encouraging them to consider evaluating the target and overbidding.

Any overbidder is likely to need to offer a materially higher price than the initial bidder, in order to try to minimise the risk that the initial bidder increases its bid price to a price higher than the overbidder's offer price. An overbidder may also be able to negotiate a recommendation from the target's directors and some deal protection measures.

### Further negotiations for recommendation

Many of those bids which begin *without* a recommendation from the target's directors are subsequently increased and receive such a recommendation. Whether, how and when a bidder with an unrecommended bid should approach the

target's directors with a proposal seeking to obtain a recommendation will depend on the dynamics of the particular transaction.

### Frustrating action and poison pills

Poison pill strategies or tactics, which make the target's securities less attractive to a bidder in the event of a hostile takeover, are generally not permissible in Australia. They are likely to be considered inconsistent with the target's directors' duties to act in the best interests of shareholders.

A 'frustrating action' is an action by the target which breaches a condition of a bid – for example, by the target undertaking a substantial acquisition after the announcement of a bid which is subject to a condition that no such acquisitions be undertaken by the target. The Takeovers Panel's policy is, broadly, that a frustrating action can only be undertaken if it is approved by a resolution of the target's shareholders<sup>23</sup>.

ASX Listing Rule 7.9 also prohibits a target from making a new issue of equity securities within three months after the announcement of a bid, without shareholder approval.

<sup>23</sup> Takeovers Panel Guidance Note 12: *Frustrating Action*.

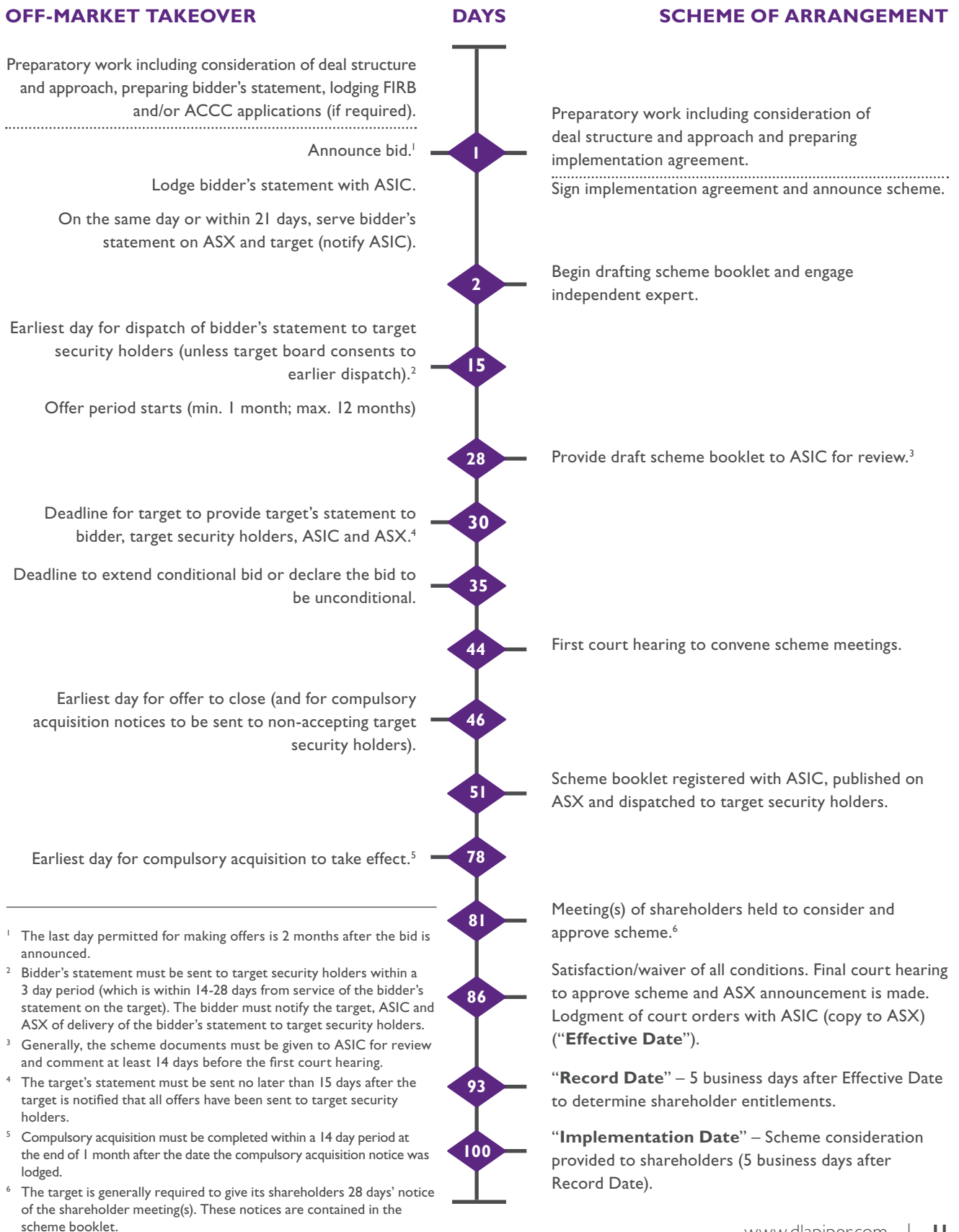


# 4. DIFFERENCES – TAKEOVER BID AND SCHEME OF ARRANGEMENT

|  | Takeover bid  | Scheme of arrangement  |
|--|---|--|
| <b>Type of target entity</b>             | An Australian entity which is listed or which has more than 50 holders of voting securities, including a company and a listed managed investment scheme.  | A company incorporated in Australia, or a body registered under Part 5.1 of the <i>Corporations Act</i> .  |
| <b>Control of process</b>                | Bidder. The bidder can announce and bid without the target's agreement, or the target's directors' recommendation. If the bid is recommended, the bidder is likely to have entered into a bid implementation agreement with the target.   | Target (subject to terms of an agreed implementation agreement). The scheme is an arrangement between the target and its 'members', or shareholders.   |
| <b>Conditions</b>                        | An off-market bid may be conditional, but an on-market bid must be unconditional.   | May be conditional.  |
| <b>Minimum acceptance</b>                | An off-market bid can have a 'minimum acceptance condition', or no minimum acceptance condition.<br><br>50.1% and 90% minimum acceptance conditions are common, because if the bidder acquires more than 50% it can determine who is elected as a director of the target, and if it reaches a holding of 90% it can compulsorily acquire the outstanding securities <sup>24</sup> . | A scheme is usually for 100% of the scheme class securities in the target. At least 75% of the shares voted (excluding securities held by the bidder), and 50% of the shareholders who vote must be in favour.   |
| <b>Consideration</b>                     | Consideration for an off-market bid may be cash and/or scrip, but consideration for an on-market bid must be cash only.   | May be cash and/or scrip.  |
| <b>Vulnerability to a blocking stake</b> | A 10% stake (held by one or more security holder) can block compulsory acquisition.   | Percentage depends on percentage of shares that are voted. Commonly, not more than 70% are voted, in which case 17.5% of shares can defeat a scheme vote. If the bidder has shares, this % may be lower, as the bidder's shares will not be included in the main voting class. |
| <b>Response to overbidder</b>            | Yes, but there is flexibility for the bidder to vary the offer terms.   | Yes, but it is not as easy for the bidder to vary the offer terms.   |
| <b>Timing</b>                            | Likely to exceed three months with uncertainty as to closing date.  | Likely to exceed three months but there is certainty as to closing date.   |
| <b>Court Approval</b>                    | Not required (the Takeovers Panel has an oversight role).   | Required (ASIC also has a formal review role).   |

<sup>24</sup> The bidder must also acquire at least 75% of the shares that the bidder offered to acquire under the bid.

# 5. INDICATIVE TIMELINE: TAKEOVER BID AND SCHEME OF ARRANGEMENT



<sup>1</sup> The last day permitted for making offers is 2 months after the bid is announced.

<sup>2</sup> Bidder's statement must be sent to target security holders within a 3 day period (which is within 14-28 days from service of the bidder's statement on the target). The bidder must notify the target, ASIC and ASX of delivery of the bidder's statement to target security holders.

<sup>3</sup> Generally, the scheme documents must be given to ASIC for review and comment at least 14 days before the first court hearing.

<sup>4</sup> The target's statement must be sent no later than 15 days after the target is notified that all offers have been sent to target security holders.

<sup>5</sup> Compulsory acquisition must be completed within a 14 day period at the end of 1 month after the date the compulsory acquisition notice was lodged.

<sup>6</sup> The target is generally required to give its shareholders 28 days' notice of the shareholder meeting(s). These notices are contained in the scheme booklet.



# 6. EXECUTING A SCHEME OF ARRANGEMENT

## *ASIC's policy and role with M&A schemes*

ASIC's policy is that it is indifferent as to whether takeovers proceed by takeover bid or scheme of arrangement, as long as target shareholders receive equivalent treatment and protection under each structure<sup>25</sup>. Because the regulation of takeover bids is far more extensive and prescriptive than the regulation of schemes, this means in effect that it is necessary to consider takeover regulation and policy when executing a scheme, and that it is often appropriate to act as though takeover regulation applied to a scheme transaction.

ASIC's policy matters, both because it is the securities market regulator and, more specifically, because the target will ask ASIC for a letter advising that it has no objection to the scheme. The Court cannot approve a scheme unless this letter has been issued<sup>26</sup>. The primary question that ASIC considers before issuing such a letter is whether target shareholders have been adversely affected by the takeover being implemented by a scheme rather than a bid<sup>27</sup>.

## *Role of the Court*

The legal basis of an acquisition scheme of arrangement is found in provisions of the Corporations Act which also deal with arrangements between a company and its creditors<sup>28</sup>. Consistently with some other provisions that deal with the resolution of creditor claims, the scheme provisions require the Court to oversee the scheme process. Specifically, the meeting at which shareholders consider and vote on a scheme must be convened, not by the directors of the target company, but pursuant to an order of the Court, sought at the 'first Court hearing' before despatch of the scheme booklet to target shareholders. Similarly, the scheme is implemented pursuant to Court orders made after an affirmative vote of shareholders, sought at the 'second Court hearing' shortly after that vote.

The Court's role is not merely to rubber stamp a proposed scheme. The Court will actively consider whether all procedural and disclosure requirements are being met in respect of the scheme. The Court will also

consider whether the scheme is fair. The Court has a discretion to not approve a scheme. When presenting the scheme to the Court, the target's lawyers act as officers of the Court, as well as acting as the target's counsel. As a result, the target's lawyers are required to disclose to the Court any information that is relevant to the exercise of the Court's discretion.

When structuring a scheme, it is important to be mindful of the Court's discretion.

The target can initiate the Court process in either a State Supreme Court or in the Federal Court of Australia.

## *Requires target's agreement*

A scheme used in Australia to acquire control of a listed or widely-held company is a 'scheme of arrangement' under section 411 of the Corporations Act. The scheme is an arrangement between the target and its 'members', or shareholders. It follows from this that a bidder cannot unilaterally initiate or implement a scheme of arrangement – the target must put the proposed scheme to a vote of its shareholders.

The bidder can bind the target to implementing the scheme by contract. The contract is usually known as a 'Scheme Implementation Agreement' or a 'Merger Implementation Agreement'.

## *Implementation agreement*

### **Deal terms**

The implementation agreement normally commits the target to proposing the scheme. The target must submit the scheme to a vote of its shareholders, and ask the Court to make orders implementing the transaction. The target must undertake the actions required to enable these processes to occur, including preparing a 'scheme booklet' of information to be sent to shareholders with the notice of meeting for the proposed resolution to approve the scheme, and approaching the Court seeking orders to convene the shareholder meeting.

<sup>25</sup> ASIC Regulatory Guide 60.17 and 60.18.

<sup>26</sup> Technically, the Court can be satisfied by other evidence that the scheme has not been proposed for the purpose of circumventing takeover regulation, but this alternative is rarely if ever pursued: section 411(17)(a) *Corporations Act 2001*.

<sup>27</sup> ASIC Regulatory Guide 60.16.

<sup>28</sup> In particular, section 411 *Corporations Act 2001*.

The bidder agrees to assist the target in proposing the scheme and to take all steps required from it to implement the scheme, including providing any information about the bidder that is needed for the scheme booklet, and, of course, paying shareholders the bid price if the scheme is approved and implemented.

### **Deal protections**

The bidder will usually have enjoyed a period of exclusivity before signing the implementation agreement. During that period, it will have conducted due diligence, and decided to proceed with the scheme.

The bidder will require exclusivity to extend until the target's shareholders vote on whether to approve the scheme. So the implementation agreement, in addition to the agreement that governed the due diligence period, will contain exclusivity provisions. These provisions are normally structured in a similar way as in a takeover bid implementation agreement, explained above, including 'no-shop', 'no due diligence', and 'no-talk' provisions, subject to appropriate 'fiduciary outs'.

### **Funding**

When a bidder or target announces a proposed scheme, it should have a reasonable basis to expect that the bidder will have funding in place to complete the scheme. To the extent that the bidder will depend on a new debt facility to complete the bid, it should have at least a binding debt commitment letter before the scheme is announced.

At the first Court hearing for the scheme, when the Court considers whether to make orders convening a meeting of target shareholders to consider the scheme, the Court will require evidence that the bid will be fully funded.

At the second Court hearing, which is held after the target's shareholders have voted on the scheme, the Court will require evidence that the scheme has been fully funded, and that the funds have been drawn down and are sitting in a trust account for the purpose of paying the target shareholders all cash that is due to them under the scheme.

### **The scheme**

Whereas the implementation agreement is legally effective because it is a contract which is enforceable at general law, the scheme itself derives its effectiveness from a Court order.

Usually the terms of the proposed scheme are set out in a schedule or annexure to the implementation agreement. The key term is the shareholders' obligation to transfer their target shares to the bidder. This obligation is expressed to be subject to the bidder paying the bid price.

Technically, the scheme is only binding between the target and its shareholders. The bidder's obligations, in particular to pay the bid price, are set out in the implementation agreement and in a deed poll (discussed below). However, to make the interaction of the several documents easier to understand, some of the bidder's obligations may be repeated in the scheme, as outcomes that will be procured by the target.

### **Deed poll**

In order to make the bidder's obligation to pay the bid price legally enforceable by target shareholders, the bidder enters into a deed poll for the benefit of the target shareholders, promising to pay the bid price to them. The deed poll mechanism makes this promise legally enforceable, even though the shareholders have not each entered into a contract with the bidder and there is therefore no general law contract directly between the bidder and the shareholders.

### **Independent expert's report**

As noted above, an independent expert's report is only required for a takeover bid in limited circumstances. A report is expressly required in the same circumstances for a scheme of arrangement<sup>29</sup>.

As a practical matter, though, an independent expert's report is required for all acquisition schemes of arrangement, because the Courts have become accustomed to seeing such reports and regard their contents as useful, both to the Court when exercising its discretion to convene the scheme meeting and to approve the scheme, and to target shareholders when assessing the merits of the scheme.

### **Scheme booklet**

A scheme booklet is sent by the target to target shareholders before the scheme meeting, to provide them with information relevant to their decisions as to how to vote on the scheme.

The booklet contains information including the notice of the scheme meeting, the terms of the scheme and the independent expert's report. Some of the information is prescribed<sup>30</sup>; and some is information that would be required for a takeover bid and is included because of ASIC's policy that target shareholders should receive

<sup>29</sup> Corporations Regulations, Schedule 8 Part 3 rule 8303.

<sup>30</sup> Corporations Regulations, Schedule 8 Part 3.

equivalent treatment as under a bid. The prescribed information includes any information material to the making of a decision as to how to vote on the scheme.

### **Scheme meeting**

The scheme meeting is a meeting of the holders of the securities which will be acquired under the scheme. For an acquisition scheme, it is usually a meeting of ordinary shareholders. The meeting is convened by order of the Court, made at the first court hearing. The meeting is conducted in accordance with the same procedural rules as an ordinary general meeting of the company.

The vote on whether to approve the scheme is normally taken on a poll. Evidence of the proceedings at the meeting, and of course the result of the vote, is submitted by affidavit at the second Court hearing.

### **Compulsory acquisition**

If the scheme is approved by at least 75% of the shares voted (excluding securities held by the bidder), and 50% of the shareholders who vote, the target asks the Court, at the second court hearing, to make orders to give effect to the scheme. One of the orders will be that all shares in the target, including the shares of shareholders who did not vote or who voted against approval of the scheme, are transferred to the bidder.

As mentioned above, before making orders to implement the scheme, the Court will require evidence that the scheme has been fully funded and that the funds have been drawn down and are sitting in a trust for the purpose of paying the target shareholders all cash that is due to them under the scheme.





# 7. TARGET'S LONG TERM PREPARATION FOR A BID OR SCHEME OF ARRANGEMENT

## *Performance and communication about performance*

The best pro-active defence against an opportunistic bid or proposal that may not reflect the fair value of the target is, of course, a strong market price of the shares or other securities in the target. Steps to help achieve that are beyond the scope of this booklet. The objectives are of course, strong business and financial performance by the target, and effective communication with the market about performance, including strategies to address any challenges that the target is facing.

## *Takeover response manual, and being ready for the initial response*

Planning for the possibility of an opportunistic bid or proposal is worthwhile. Such a bid or proposal can arrive at any time – including just before or during a holiday season. The nature of the target's initial response does matter. The response must be considered and confident – even if it is in essence merely a holding response. The nature and tone of the response can influence the next step of the bidder or proponent, and the confidence of the target's shareholders or securities holders in the ability of the target's board to deal with the bid proposal.

A considered and confident initial response, and subsequent steps, are more likely if the executives and directors who will be involved in the response have, in advance, an understanding of the issues and process that will be relevant to their response, and have an action plan. The action plan should include an allocation of task responsibilities and drafts of announcements or media releases that are likely to be required. The plan should also include a draft action list for the first forty-eight hours after receiving an unsolicited bid or proposal.

DLA Piper can customise and provide a Takeover Response Manual, and a briefing, to ensure that its clients are prepared for an opportunistic bid or proposal. In our experience, being prepared makes a material difference to the effectiveness of a target's response.

## *Takeover response team*

A response team structure that includes the right people without being unwieldy may include: a Board sub-committee comprising the Chairman and up to three other non-executive directors (none of whom should have any association with the bidder); the executive takeover response team, comprising the Chairman, the CEO and probably the CFO and General Counsel; the target's legal advisers, and the target's investment bank or financial adviser. Often a project manager or 'response co-ordinator' is nominated as the person responsible for organising deliverables from executives in different functional areas, with these executives having also been nominated in advance as part of the response plan.

## *Monitoring substantial shareholdings, and tracing beneficial ownership*

A listed or widely held entity may want to understand who has or is accumulating a stake in the entity which may be strategic or, potentially, a pre-bid stake.

In the case of a listed entity, anyone who has acquired a 'substantial holding' must disclose it. A 'substantial holding' is held if a person's 'relevant interest' in voting securities in the entity, plus the 'relevant interests' of their associates, exceeds 5% of all voting securities of the relevant class. Broadly, a 'relevant interest' is power (positive or negative) over the voting or disposal of the securities.

Changes of 1% or more in a substantial holding are also notifiable.

A listed or widely held entity has, of course, access to its own registers of security holders. But many of those holdings will be through nominees, and will be below the 5% substantial holder notification threshold. To interrogate such holdings, an entity may use the procedure available through the Corporations Act<sup>31</sup> to trace the beneficial ownership of securities. Some entities invoke this procedure from time to time to monitor the beneficial ownership of shares. Many use it if they know or suspect that some strategic buying of securities is or may be occurring.

<sup>31</sup> Part 6C.2.

# 8. THE CORE REGULATION AND TECHNICAL TERMS

## **The core prohibition**

As noted above, in Australia there is a general prohibition on acquiring more than a 20% holding of voting securities in a listed or widely held entity, unless one of several permitted transaction structures is used.

The prohibition is set out in section 606 of the Corporations Act. Broadly, it prohibits acquisitions of voting securities which would take anyone's 'voting power' through 20%, or increase anyone's voting power from a starting point that is above 20% and below 90%.

'Voting power' is a compound concept, explained below.

Generally, Australian entities which are listed or which have more than fifty holders of voting securities are subject to the core prohibition. 'Entities' in this context includes companies incorporated in Australia, and listed managed investment schemes.

## **"Voting power"**

This concept is at the heart of determining what acquisitions are prohibited by the core prohibition. It is a compound concept.

A person's voting power is calculated as:

- the votes attached to the securities in which the person has a relevant interest, plus
- the votes attached to the securities in which the person's associates have a relevant interest,

expressed as a percentage of all voting securities of the relevant class<sup>32</sup>.

## **"Relevant interest"**

A person has a relevant interest in voting securities if the person has the power to vote the securities, or has power over the disposal of the securities<sup>33</sup>. A power to block or veto (negative power) is sufficient. In some circumstances, a 'deemed' relevant interest can arise. Where a relevant interest will be acquired pursuant to a contract, and conditions precedent under the contract have not yet been satisfied, the conditions precedent can be deemed to be satisfied<sup>34</sup>.

## **"Associate"**

A person is an associate of a second person if:

- they are both companies in the same group;
- the two persons have an agreement or understanding relating to the composition of the relevant target company's board, or the conduct of its affairs; or
- the two persons are acting, or propose to act, in concert in relation to the relevant target company's affairs.

Where the target is a managed investment scheme and not a company, two persons are associates if they have an agreement or understanding relating to whether the responsible entity of the scheme remains in place or is replaced<sup>35</sup>.

## **Policy based regulation**

The provisions relating to takeover bids (which apply to schemes by virtue of ASIC's policy, described above, that target shareholders should receive equivalent treatment

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<sup>32</sup> Section 610 *Corporations Act 2001*.

<sup>33</sup> Sections 608 – 609 *Corporations Act 2001*.

<sup>34</sup> Section 608(8) *Corporations Act 2001*.

<sup>35</sup> Section 12 *Corporations Act 2001*.



under a scheme or bid) are set out in Chapter 6 of the Corporations Act. The purposes of these provisions are to ensure that:

- the acquisition of control over voting securities in relevant entities takes place in an efficient, competitive and informed market; and
- the holders of voting securities, and the directors of the relevant entity:
  - know the identity of any person who proposes to acquire a substantial interest in the entity; and
  - have a reasonable time to consider the proposal; and
  - are given enough information to enable them to assess the merits of the proposal; and

- as far as practicable, the holders of the relevant class of voting securities 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 entity<sup>36</sup>.

The Takeovers Panel makes its decisions with reference to these policies. It is often less concerned with technical contraventions of the law, especially if corrective action can be taken with respect to the technical breach, than it is with action or inaction which would contravene one or more of the purposes of Chapter 6, set out above.

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<sup>36</sup> Section 602 *Corporations Act 2001*.



# 9. REGULATORS AND TAX

## **Takeovers Panel**

As noted above, the Takeovers Panel is an administrative tribunal and not a court. Its procedures are less rigorous than a court's, and it makes determinations more quickly than a court<sup>37</sup>.

The Takeovers Panel is the primary forum for complaints about alleged defects in takeover transactions in Australia. The Panel seeks to make decisions quickly, by focusing primarily on commercial and policy issues.

The Takeovers Panel may review a decision of ASIC in relation to an application to modify or vary one of the takeover provisions of the Corporations Act in particular circumstances.

More commonly, the Takeovers Panel is asked by an interested party to declare circumstances to be unacceptable in relation to the affairs of an entity in the context of a change of control proposal or transaction.

The Takeovers Panel makes its decisions with reference to the purposes of Australia's takeover regulation, and may declare circumstances to be unacceptable even if there is no contravention of the takeover provisions.

The Takeovers Panel considers the effect that the circumstances complained of have had, are having or are likely to have on the control or potential control of the relevant entity, or the acquisition or proposed acquisition of a substantial interest in the relevant entity.

The Takeovers Panel can make a wide range of orders, including standstill or divestiture orders, or orders requiring corrective or further disclosure.

As noted above, the Takeovers Panel is amenable to any curable defects in the bidder's conduct being addressed by remedial actions by, or by undertakings given by a party.

## **Australian Securities & Investments Commission (ASIC)**

ASIC notes that its regulatory role in the administration and conduct of takeover bids primarily involves:

- the review and monitoring of documentation, disclosures and conduct in relation to bids to ensure compliance with the takeover provisions and the purposes underlying the takeover provisions;
- providing regulatory guidance and relief that improve commercial certainty and balance the protections of the takeover provisions with the objective of facilitating takeover transactions; and
- in appropriate cases, taking enforcement action to protect the interests of investors and promote their confident and informed participation in the takeover process and financial markets generally<sup>38</sup>.

ASIC's power to provide regulatory relief is a power to exempt a person from one of the takeover provisions in Chapter 6 of the Corporations Act, or to declare that the takeover provisions apply in a particular case as though they were modified or varied in a specified manner. In deciding whether or not to give relief, ASIC must have regard to the purposes of the takeover provisions<sup>39</sup> (which are set out under 'Policy based regulation' in Part 8 above).

ASIC's role in relation to schemes of arrangement has been described elsewhere in this booklet.

## **Foreign Investment Review Board (FIRB)**

Some acquisitions by foreign persons or entities must be notified to the Treasurer of the Australian Federal Government. The Treasurer has the power to prevent some transactions, if he or she considers that they are contrary to Australia's national interest. This power is very rarely exercised.

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<sup>37</sup> Part 6.10, Division 2 *Corporations Act 2001*.

<sup>38</sup> ASIC Regulatory Guide 9 – Takeover Bids paragraph 6.

<sup>39</sup> Section 655A *Corporations Act 2001*.

FIRB is the advisory body within the Australian Federal Government responsible for examining proposals and advising the Treasurer on the national interest implications of investment proposals. The Treasurer retains responsibility for making decisions<sup>40</sup>.

Notifiable transactions include a proposed acquisition of a direct interest in an agribusiness, a substantial interest (20%) in an Australian entity, and of an interest in Australian land.

The screening threshold for agricultural land is a generally cumulative total of \$15 million (as at late 2015) – different thresholds apply to different countries with which Australia has a free trade agreement. The screening threshold for Australian entities (as at late 2015) is generally \$252 million, or \$1,094 for certain countries with which Australia has a free trade agreement. There is no threshold for foreign government acquirers. There are technical provisions prescribing how values are calculated for the purposes of the thresholds.

A foreign person who gives a notice must not enter into the agreement for a specified period (generally 40 days) unless the person is given a no objection notification.

### **Australian Competition and Consumer Commission (ACCC)**

An acquisition may be prohibited under Australian competition law if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a substantial market in Australia, or in a state, territory or region of Australia in any market<sup>41</sup>.

The ACCC is the regulator which administers this prohibition. It has issued guidelines outlining its administration and enforcement policy.

The analysis of whether an acquisition may be prohibited begins with defining the relevant market or markets, and then considers the competition effect of the acquisition in that market or those markets.

After conducting this analysis, bidders in most transactions conclude that no issue will arise under the prohibition. Where a bidder considers that an issue may arise under the prohibition, it will consider whether and how to approach the ACCC ahead of the proposed

transaction. It will also consider whether its takeover bid or scheme needs to be subject to a condition in relation to competition issues.

While there is no statutory requirement to apply for approval for a proposed acquisition, there are three ways that a party can seek approval:

- apply to the ACCC for an informal (non-binding) review;
- apply to the ACCC for formal clearance; or
- apply to the Australian Competition Tribunal for authorisation of a proposed acquisition on public benefit grounds.

An application for informal clearance is the most common process. The ACCC is prepared to advise, after considering the effect of a proposed acquisition, whether it would take any action if the acquisition were to proceed. If the ACCC advises that it does not intend to take any action, it reserves the right to reconsider the transaction if it receives new information or becomes aware that information already supplied is incomplete or incorrect.

### **Tax**

A discussion of tax issues relevant to takeovers in Australia is beyond the scope of this booklet. The taxes that may be relevant to a takeover transaction include:

- stamp duty – a transfer tax on securities in some circumstances;
- capital gains tax or income tax for holders of securities in the target; and
- that the efficient use of ‘franking credits’ (tax credits can be passed to target shareholders along with dividends) of the target.

In addition, a bidder will want to plan its acquisition structure to ensure that it is not tax inefficient. This planning may extend to ultimate exit strategies from the acquisition. For offshore bidders, particular issues such as withholding tax, thin capitalisation, transfer pricing and concessional tax arrangements may be relevant.

DLA Piper advises on all acquisition and cross-border tax issues.

<sup>40</sup> Paragraph 15.13 Explanatory Memorandum, Foreign Acquisitions And Takeovers Legislation Amendment Bill 2015.

<sup>41</sup> Section 50 *Competition And Consumer Act 2010*.

# 10. TRUST SCHEMES

A takeover bid can be made for listed bodies that are incorporated or formed in Australia but that are not companies. This includes listed bodies which are unit trusts formed in Australia.

A scheme of arrangement can be used where the target is a company registered in Australia, or a body registered under Part 5B.2 of the Corporations Act<sup>42</sup>. A scheme of arrangement cannot be used where the target is, for example, a listed unit trust. A number of entities listed in Australia are unit trusts<sup>43</sup>.

For unit trusts, as an alternative to a takeover bid, a 'trust scheme', can be used. This is usually effected by amendment of the constitution following one or more votes of holders of voting securities in the target. There are generally two types:

- a redemption scheme: this involves all the units in the target, except those held by the bidder, being redeemed. Cash or interests in the bidder may be paid to the former unit holders in the target as consideration for the redemption. The target can be delisted before any units in it are issued to the bidder. This avoids any breach of the core takeovers prohibition, which does not apply to unlisted unit trusts; and
- a transfer scheme: this involves all the units in the target being transferred to the bidder. Transfer schemes cannot be implemented without an approving vote of unitholders, for the purposes of item 7 of s611 of the Corporations Act (see below). Votes cannot be cast in favour by persons proposing to acquire or dispose of their units, so this transaction type requires a modification of the law by ASIC<sup>44</sup>.



<sup>42</sup> Sections 9 and 411 *Corporations Act 2001*.

<sup>43</sup> A unit trust is a trust in which beneficial interests are represented by securities which are called 'units'.

<sup>44</sup> This description is based on the description in paragraph 5 of the Takeovers Panel's Guidance Note 15: *Trust Scheme Mergers*.



## II. ACQUISITIONS BY APPROVAL OF THE HOLDERS OF VOTING SECURITIES

As mentioned in the introduction to this booklet, in Australia there is a general prohibition on acquiring more than a 20% holding of voting securities in a listed or widely held entity, unless one of several permitted transaction structures is used. The two most common transaction structures used in Australia to acquire control of a listed or widely-held entity are a 'takeover bid' and a 'scheme of arrangement'.

Another possible structure is with the approval of the holders of the relevant class of voting securities in the target, by a resolution voted on by them. No votes may be cast by the acquirer (or its associates), or the seller (or its associates)<sup>45</sup>.

Because of these disqualifications from voting, and because the acquisition which is the subject of the proposed resolution will be set out in an agreement with a limited number of parties, this structure is not likely to be able to be used for an acquisition of all the voting securities in a target.

It is most often used for the acquisition or increase of a substantial strategic stake, in circumstances where it is expected that the holders of voting securities who are not parties to the acquisition transaction will support the transaction by voting in favour of it. It is also used for a 'back door listing', where a vendor or vendors sell a

business or company to a listed company which does not have a substantial business, and are issued with sufficient new shares in the target to emerge with control of it.

This structure can be used for the acquisition of existing voting securities, or for the issue of new securities, in circumstances where the acquirer's voting power in the target would be more than 20% after the acquisition.

The notice of meeting for the vote on the resolution must include all information material to the decision on how to vote on the resolution. It is ASIC's policy that this information must normally include an independent expert's report on whether the transaction is fair and reasonable to non-participating holders of the relevant class of voting securities. In some circumstances, a detailed report by directors may be acceptable to ASIC<sup>46</sup>.

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<sup>45</sup> Item 7, section 611 *Corporations Act 2001*.

<sup>46</sup> ASIC Regulatory Guide 74, paragraphs 29 to 42.

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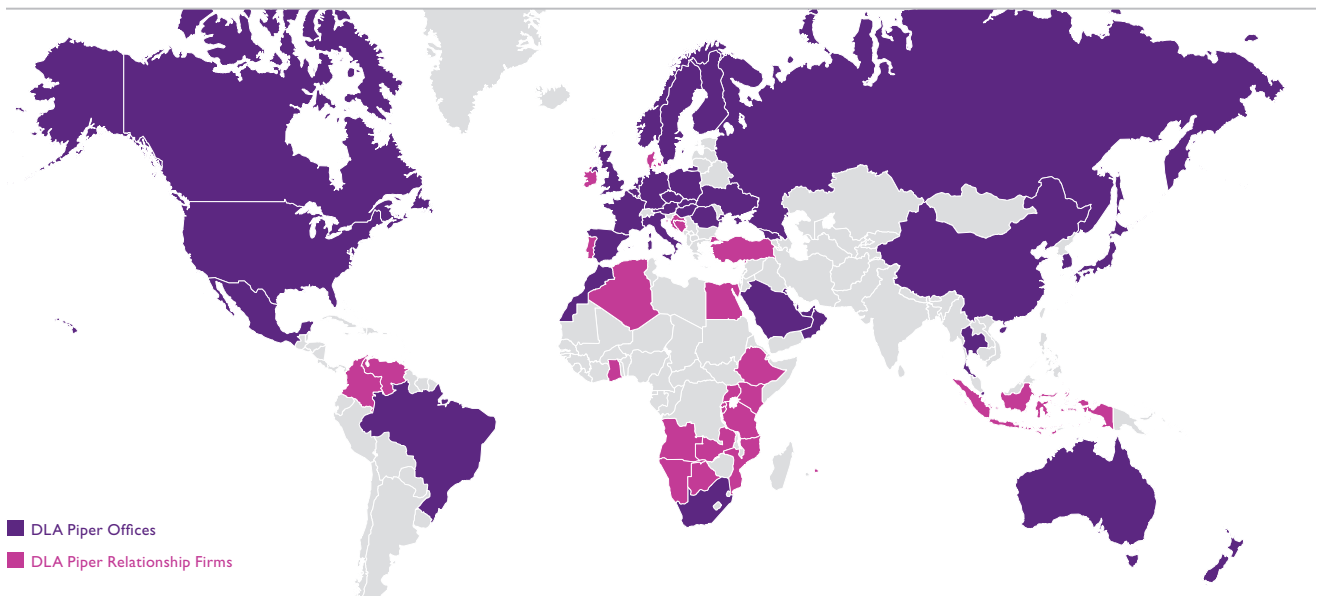
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