

C L I F F O R D
C H A N C E

WHAT'S MARKET?

EXCLUSIVITY AND COST REIMBURSEMENT DURING THE PRE-BID PHASE

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Overview

After the surge of deal activity in Australian public markets in 2021 and the first half of 2022 and decisions of the Takeovers Panel (the **Panel**) in relation to exclusivity arrangements in a number of highly contested transactions (*Ausnet Services Limited 01 and Virtus Health Limited 01 and 02*), the Panel commenced consultation on reforms to Guidance Note 7: Lock Up Devices. In August 2023, the Panel released its refreshed guidance, which included renaming the guidance note to *Guidance Note 7: Deal Protection*.

While the refreshed guidance represented a further step in the evolution of the approach to deal protection mechanisms in Australia, for the most part it provided guard rails but did not impose bright line rules for deal protection at the earliest stages of a potential take-private which is in keeping with the general approach to takeovers regulation in Australia.

Six months on from the release of the refreshed guidance, we are continuing to see a range of approaches to exclusivity which are informed by the circumstances of particular transactions. Potential bidders are continuing to try to extract as much certainty as they can from Target Boards and Target Boards remain willing to entertain exclusivity discussions during the pre-bid phase when the price is right.

Key Points

- It is not unusual (but nor is it customary) for a bidder to be granted exclusivity to undertake due diligence and negotiate transaction documents prior to a binding implementation deed being signed (i.e. at the pre-bid phase). There are also examples of bidders being given cost coverage during that phase, although these are relatively less common.
- Hard exclusivity continues to be granted to bidders during the pre-bid phase, but only for up to four weeks and in the circumstances contemplated by Guidance Note 7. In other circumstances or for longer periods of time, exclusivity is granted subject to a customary fiduciary carve-out.
- If the pre-bid deal protections include a notification obligation or an agreement by the target board to either recommend a transaction if the bidder puts a binding proposal on the terms of its indicative proposal or pay a material fee if the target board fails to recommend such a binding proposal, then the target should disclose the material terms of the deal protection arrangements upon entering them. Otherwise, the target may keep the deal protection arrangements confidential for so long as the potential transaction also remains confidential.

NBIOs and NDAs

It is customary for a party (**Bidder**) seeking to privatise an ASX-listed entity (**Target**) to submit a non-binding, indicative and confidential proposal (**NBIO** or **Proposal**) to the board of the Target (**Target Board**) to initiate formal engagement with the Target Board about the terms on which the Target Board may agree to formally support the Proposal and put the Proposal to the Target's shareholders for consideration. More often than not (but not always), the Target Board will maintain the confidentiality of the Proposal in reliance on the exceptions to the continuous disclosure obligations of an ASX-listed entity – specifically, the exception which permits non-disclosure of price sensitive information which is confidential, concerns an incomplete proposal or negotiation and which a reasonable person would not expect to be disclosed.

If the Target Board is willing to explore the merits of a Proposal, the Bidder and the Target would typically then negotiate and enter into a confidentiality agreement (or non-disclosure agreement) (**NDA**) under which the Target Board agrees to make confidential information about the Target available to the Bidder, subject to confidentiality (and often standstill) restrictions to protect the non-public nature of the information. It is in the context of this negotiation that exclusivity and cost reimbursement provisions of the kind outlined in this note are often raised by a Bidder and, if accepted by the Target Board, documented as between the parties, typically in a stand-alone exclusivity or process deed (**Process Deed**).



Traditional lock-up devices at the NBIO stage

(a) No shop restriction

A no shop restriction is a restriction on the Target from soliciting competing offers to a Proposal (**Competing Proposal**) – that is, it prevents the Target from running a process to invite proposals which may be superior to that which has already been received.

(b) No talk restriction

A no talk restriction is a restriction on the Target from negotiating or entering into discussions with any third party regarding a Competing Proposal, even if that third party's Competing Proposal was not solicited by the Target.

(c) No due diligence restriction

A no due diligence restriction is a restriction on the Target from enabling a third party to undertake due diligence investigations on the Target, with a view to obtaining a Competing Proposal from such third party or assisting such third party to develop a Competing Proposal.

(d) Notification obligation

A notification obligation requires the Target to notify the Bidder if it receives a Competing Proposal from, or is approached by, any third party requesting discussions or due diligence access concerning a Competing Proposal.

(e) Matching right

A matching right gives the Bidder the right to provide a matching or superior proposal to any Competing Proposal before the Target may enter into any legal binding agreement to give effect to or implement the Competing Proposal.

(f) Information right

An information right requires the Target to disclose to the Bidder any non-public information that is provided to any person in connection with a Competing Proposal which has not previously been made available to the Bidder. This obligation is

sometimes coupled with a requirement that any NDA the Target signs with a competing bidder is no more favourable to the competing bidder than the terms of the Bidder's NDA with the Target.

(g) Fiduciary out

A fiduciary out permits the Target Board to act contrary to a deal protection restriction where their fiduciary duties require them to do so – in other words, where that act relates to a Competing Proposal which is, or could reasonably be expected to lead to a proposal that is, superior to the Proposal.

Guidance Note 7: Deal Protection

Guidance Note 7: Deal Protection (Guidance Note 7) applies to all change of control transactions in respect of widely held entities, irrespective of whether they are being implemented by way of scheme of arrangement, takeover bid or any other transaction which is likely to affect control or potential control of an entity or the acquisition of substantial interest in an entity and apply to non-binding proposals, binding proposals and committed deals.

Deal protection devices are not per se unacceptable and the Panel recognises that in some cases they are needed to facilitate the making of a control proposal which is in the best interests of shareholders. Nonetheless, the main policy basis underlying Guidance Note 7 is that “deal protection devices may inhibit the acquisition of control over voting shares or interests taking place in an efficient, competitive and informed market” and, having regard to that policy basis, the following key principles apply:

- a customary no shop restriction does not require a ‘fiduciary out’;
- in the absence of an effective ‘fiduciary out’ that is available to target directors in practical terms, a no talk restriction is likely to give rise to unacceptable circumstances;

- safeguards applicable to no talk restrictions apply similarly to no due diligence restrictions – that is, they too must be subject to an effective ‘fiduciary out’;
- notification obligations, matching rights and information rights need not be subject to a ‘fiduciary out’; and
- the duration of any matching right should not exceed 5 business days.

Additionally, with respect to deal protection at the pre-bid phase, the following specific guidance from the Takeovers Panel applies:

- while the grant of hard exclusivity (that is, a no talk and/or no due diligence restriction that is not subject to a ‘fiduciary out’) will generally give rise to unacceptable circumstances, it may not be unacceptable for a Target Board to grant a limited period of hard exclusivity in circumstances where:
 - a. a major shareholder has made a bid for the Target (or a Bidder has the support of a major shareholder) and the Target Board considers that granting hard exclusivity would be required for another Bidder to enter the process and stimulate competition for the Target;

- b. the Target Board has conducted an auction process or a fulsome sounding out of the market and is aware of a potential Bidder for the Target and considers that granting hard exclusivity will encourage an offer to be made;
 - c. the Target Board has granted hard exclusivity to extract a material price increase from an existing Bidder; or
 - d. there is a single Bidder for the Target and the Target Board considers it unlikely that any competing bid at a higher price will emerge, the Target Board considers that the price offered fairly values the Target and the Target Board considers that granting hard exclusivity to that Bidder would potentially enable the proposal to progress to binding status;
- if hard exclusivity is granted, the Takeovers Panel would generally expect that the period of hard exclusivity would be short and limited to no more than 4 weeks; and
 - further, and notwithstanding the specific guidance above, the Takeovers Panel will look at the circumstances as a whole and the context in which the arrangement was entered into in considering whether or not a hard exclusivity arrangement is unacceptable.

Break fees and cost reimbursement

The other category of deal protection that can be used are break fees and cost reimbursement provisions. While break fees and cost reimbursement provisions are a common feature of an agreed deal and documented in a scheme implementation or bid implementation deed, they are less common at the NBIO phase.

A break fee is a liquidated sum payable to the Bidder on the occurrence of a specified event.

A cost reimbursement obligation is a promise by the Target to pay the Bidder's out of pocket costs in pursuing the Proposal.

In practice, the events that crystallise a Target's obligation to pay a break fee or cost reimbursement amount in respect of the non-binding bid phase of a control transaction are the same and include:

- the Target declining to enter into an implementation agreement on agreed NBIO terms;
- the Target not complying with its Process Deed obligations;
- the Target receiving a competing proposal during the Bidder's exclusivity period and the Target entering into a legally binding agreement to give effect to that competing proposal; and
- a material issue concerning the Target becomes known to the Bidder during the exclusivity period of which the Target was aware as at the date of the Process Deed and which ought to have been disclosed by the Target prior to that date.



What's Market?

We've surveyed Australian market practice for exclusivity in the pre-bid phase and looked at 17 recent transactions in which the potential Bidder was granted one or more of the exclusivity and cost reimbursement arrangements described in this document (such transactions being referred to as **Surveyed Transactions**).

The Surveyed Transactions show:

- the most common form of deal protection granted (unsurprisingly) is a no shop provision. These provisions invariably are not subject to a 'fiduciary out' but in effect provide little protection against the appearance of an interloper after the Proposal has been disclosed to the market;
- where exclusivity is granted in the pre-bid phase, no talk and no due diligence restrictions and notification obligations typically form part of the package, but matching rights are less common;
- exclusivity periods range from as short as 15 Business Days to as long as 10 weeks;
- there is an emerging practice of the 'fiduciary out' for no talk and no DD provisions being suspended for a period of time giving a short period of "hard" exclusivity to the Bidder;

however, in line with the revised Guidance Note 7, that period generally does not exceed 4 weeks. In effect, this allows the Bidder to have clear air in the data room and with the Target to negotiate definitive transaction documents; and

- costs reimbursement provisions remain less common, and break fees are rare at the NBIO stage. Nonetheless, where a Target Board is actively trying to secure a binding transaction, agreeing to underwrite part of the costs of the potential Bidder can be helpful in eliciting a mutually acceptable Proposal.

The table in the annexure provides more detail on the Surveyed Transactions.



What's next?

Deal protection at the earliest stages of a transaction will remain a key priority for Bidders in 2024 as investor interest in take-private transactions remains strong but deal execution continues to be challenged.

While we are still seeing some auction style activity for specific Targets, we do think Target Boards who see shareholder value in control transactions will be willing to consider offering potential bidders one or more forms of deal protection to ensure that the potential Bidder puts its best price forward or to attract a “white knight” to scuttle an existing Proposal. Indeed, as market practice continues to converge around the revised Guidance Note 7, we expect that Bidders will increasingly press for the limits of what is defensible in accordance with that guidance, but in doing so Bidders will be mindful of mandatory disclosure triggers (such as notification obligations) and tailor their exclusivity requests accordingly.

Cost coverage and break fees will remain less common (relative to exclusivity) in 2024; however, with transactions remaining under challenge due to regulatory concerns and interloper interest, we do think that private equity Bidders will increasingly focus on this aspect of their pre-bid arrangements with Target Boards as they seek to share the downside of deals not getting done.



Surveyed Transactions

| Target | NBIO announcement date | Bidder | Price bump ¹ | Exclusivity period | No shop ² | No talk and/or no due diligence | Fiduciary out to no talk and/or no due diligence | Notification of approaches | Matching right | Cost reimbursement | Break fee |
|-------------------------|------------------------|----------------------------|--|--------------------|----------------------|---------------------------------|--|----------------------------|----------------|-----------------------|---------------------------------|
| Adbri | 18 December 2023 | CRH & Barro | ✗ | ~Two months | ✓ | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |
| Naomi Cotton | 28 November 2023 | Louis Dreyfus Company Asia | ✗ | ~Two months | ✓ | ✓ | ✓ Fiduciary out suspended for 4 weeks | ✓ | ✗ | ✓ Capped at \$500k | ✗ |
| Damstra Holdings | 22 November 2023 | Ideagen | ✗ | One month | ✓ | ✓ | ✓ Fiduciary out suspended for 4 weeks | ✓ | ✗ | ✗ | ✗ |
| Symbio Holdings | 29 September 2023 | Aussie Broadband | ✗ NBIO submitted following Superloop's proposal | 15 Business Days | ✓ | ✓ | ✗ | ✓ | ✗ | ✗ | ✓ Work fee of \$1.35 million |
| Estia Health | 7 June 2023 | Bain Capital | ✓ 6.67% price bump to secure exclusivity | 30 Business Days | ✓ | ✓ | ✓ Fiduciary out suspended for 20 days | ✓ | ✓ | ✗ | ✗ |

1 Reporting is on the basis of publicly disclosed price increases prior to exclusivity and diligence access being granted.

2 No shop clauses are generally not subject to fiduciary outs and we have seen no evidence that shows a departure from this common practice.

| Target | NBIO announcement date | Bidder | Price bump ¹ | Exclusivity period | No shop ² | No talk and/or no due diligence | Fiduciary out to no talk and/or no due diligence | Notification of approaches | Matching right | Cost reimbursement | Break fee |
|------------------------------|------------------------|----------------------------------|--|---|----------------------|---------------------------------|--|----------------------------|----------------|---|-----------|
| InvoCare | 15 May 2023 | TPG | ✓ 2.77% price bump to secure exclusivity | 5 weeks, which could be extended by 2 weeks following confirmation of price | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ | ✗ |
| United Malt | 28 March 2023 | Malteries Soufflet SAS | ✓ 20.48% price bump to secure exclusivity | 10 weeks | ✓ | ✓ | ✓ Fiduciary out suspended for 4 weeks | ✓ | ✓ | ✓ Capped at \$5m | ✗ |
| Australian Unity Office Fund | 3 June 2022 | Aliro Group | ✗ Aliro Group has secured a voting intention statement from 19.97% unitholder | 4 weeks, that could be extended to 8 weeks following price confirmation. | ✓ | ✓ | ✓ | ✓ | ✗ | ✓ Capped at \$2m | ✗ |
| Uniti Group | 15 March 2022 | Morrison / Brookfield Consortium | ✗ | Date of deed until 4 weeks after data room open date | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ | ✓ \$5m |
| Angel Seafood | 20 December 2021 | Laguna Bay | ✗ | 7 weeks | ✓ | ✓ – no talk ✗ – no DD | ✓ – no talk N/A – no DD | ✗ | ✗ | ✓ Capped at \$200K provided bidder doesn't cease to participate in process in good faith | ✗ |

| Target | NBIO announcement date | Bidder | Price bump ¹ | Exclusivity period | No shop ² | No talk and/or no due diligence | Fiduciary out to no talk and/or no due diligence | Notification of approaches | Matching right | Cost reimbursement | Break fee |
|---|------------------------|---------------|--|--|----------------------|---------------------------------|---|----------------------------|----------------|--|-----------|
| Australian Pharmaceutical Industries | 16 September 2021 | Wesfarmers | ✓ 12.32% price bump to secure exclusivity | 30 days | ✓ | ✓ – no talk ✗ – no DD | ✓ – no talk N/A – no DD | ✗ | ✗ | ✗ | ✗ |
| Iress | 11 August 2021 | EQT | ✓ 7.50% price bump to secure exclusivity | Date of deed until earlier of entry into SID or 30 days after date of deed | ✓ | ✓ | ✓ – no talk only but only if a relevant proposal has been made and Bidder has been notified and had opportunity to match ✗ – no DD | ✓ | ✗ | ✗ | ✗ |
| Hansen | 7 June 2021 | BGH Capital | ✗ | 6 weeks | ✓ | ✓ | ✓ – no talk ✗ – no DD | ✓ | ✓ | ✗ | ✗ |
| Capral | 14 April 2021 | Allegro Funds | ✗ | One month with automatic 2 week extension if bidder confirms its initial offer price is only subject to confirmatory DD. | ✓ | ✗ | N/A | ✓ | ✗ | ✓ Capped at \$350k if price confirmation is given at end of due diligence period or, capped at \$700K if bidder provides firm offer price confirmation before end of due diligence period | ✗ |

| Target | NBIO announcement date | Bidder | Price bump ¹ | Exclusivity period | No shop ² | No talk and/or no due diligence | Fiduciary out to no talk and/or no due diligence | Notification of approaches | Matching right | Cost reimbursement | Break fee |
|------------------------------|------------------------|-----------------------------|---|---|----------------------|---------------------------------|--|----------------------------|----------------|--------------------|--------------|
| Think Childcare Group | 6 April 2021 | Busy Bees | ✓ 52.38% price bump from initial offer from Busy Bess and 82.86% higher than highest initial offer from competing bidder | 40 days | ✓ | ✓ – no talk ✗ – no DD | ✓ – no talk N/A – no DD | ✓ | ✓ | ✗ | ✗ |
| Village Roadshow | 18 May 2020 | BGH Capital | ✗ Bid undertaken during early phases of COVID19 Pandemic | 4 weeks, that could automatically extend to e 6 weeks. | ✓ | ✓ – no talk ✗ – no DD | ✓ – no talk ✗ – no DD | ✗ | ✗ | ✗ | ✓ \$4.29m |
| Windlab | 20 January 2020 | Federation Asset Management | ✗ | 5 weeks with automatic extension of 5 days if bidder confirms it has substantially completed DD and it wishes to proceed at least at the Offer Price. | ✓ | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |

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This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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