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A REMINDER ON PERMISSIBLE FETTERS TO 'FIDUCIARY OUT' CLAUSES

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Legal Briefings – By **Tony Damian and Amelia Morgan**

In the current *Real Energy Corporation Ltd* scheme, the parties agreed to execute a Deed of Variation to the Scheme Implementation Agreement to remove a 'reasonableness' requirement in the fiduciary exception to the 'no talk', 'no due diligence' and 'notification of unsolicited approaches' obligations.

IN BRIEF

• The original Scheme Implementation Agreement between Real Energy Corporation Ltd and Strata-X Energy Ltd contained a fiduciary out to the 'no-talk', 'no due diligence' and 'notification of unsolicited approaches' obligations which required the relevant boards to 'act reasonably' in determining whether a failure to respond to a competing proposal would be reasonably likely to constitute a breach of the relevant board's fiduciary or statutory obligations.

• Consistent with the Takeovers Panel's decision in *Ross Human Directions Ltd* [2010] ATP 8, the parties agreed to execute a Deed of Variation to the Scheme Implementation Agreement to remove this requirement.

BACKGROUND

On 15 July 2020, Real Energy Corporation Ltd (**Real Energy**), an ASX-listed oil and gas explorer, announced that it had entered into a Scheme Implementation Agreement (**SIA**) to pursue a nil premium scrip merger with Strata-X Energy Ltd (**Strata**) to create Pure Energy Corporation Ltd.

The SIA included a number of customary exclusivity provisions, including 'no talk' (clause 9.3 of the SIA), 'no due diligence' (clause 9.4 of the SIA) and 'notification of unsolicited approaches' (clause 9.7(a) of the SIA) obligations. These obligations were subject to the fiduciary obligations of the directors of Real Energy ('MergCo' for the purpose of the SIA) and Strata (the 'Buyer' for the purpose of the SIA).

The fiduciary exception was originally drafted as follows:

"Clause 9.3 and clause 9.4 and the obligation under clause 9.7(a) to inform the Buyer or MergCo respectively, of the identify of a potential Third Party Buyer or acquirer do not apply to the extent that they restrict the MergCo or Buyer from taking or refusing to take any action with respect to a genuine potential Competing Transaction (which was not solicited, invited, encouraged or initiated by them in contravention of clause 9.2) provided that they, through the board has determined, in good faith and acting reasonably [emphasis added] that:

a. *after consultation with its financial advisers, such a genuine Competing Transaction is, or could reasonably be considered to become, a Superior Proposal; and*

b. *after receiving legal advice from its external legal advisers (who must be reputable advisers experienced in transaction of this nature) that failing to respond to such a genuine Competing Transaction would be reasonably likely to constitute a breach of the MergCo or Buyer Board's fiduciary or statutory obligations."*

ASIC'S CONCERNS

In *Real Energy Corporation Limited* [2020] FCA 1634, Justice Yates of the Federal Court of Australia noted that ASIC had expressed a concern about the inclusion of the words 'and acting reasonably' in the fiduciary exception set out above. Justice Yates said that ASIC regarded these words as adding an inappropriate 'reasonableness' requirement on the directors in determining their fiduciary and statutory duties.

His Honour cited the matter of *Ross Human Directions Ltd* [2010] ATP 8 where the Takeovers Panel said that it is inappropriate to impose an additional 'reasonableness requirement' on a target board in determining what their fiduciary and statutory duties are, beyond requiring the target board to obtain external legal advice that failing to respond would likely breach those duties.

To satisfy ASIC's concern, Justice Yates noted that Real Energy and Strata had agreed to execute a Deed of Variation to the SIA to remove the relevant words within seven days of the Court making orders to convene the scheme meeting. In addition, Real Energy gave an undertaking that a copy of the Deed of Variation would be made available to the members in the same way that the scheme booklet would be made available to them.

Justice Yates also commented that the 'Exclusivity Period' during which the exclusivity provisions in the SIA applied (which was a period of up to nine months after the date of the SIA in this case) was 'somewhat lengthy', but not so lengthy as to cause significant concern as to its possible anti-competitive consequences.

PRACTICE POINTS

The *Real Energy* matter serves as a reminder that, in drafting and negotiating fiduciary out clauses, bidders and targets must remain mindful that there are limits to the hurdles that a target board can be made to clear.

The matter cited the Takeovers Panel's decision in *Ross Human Directions* [2010] ATP 8, where the Panel stated that an additional 'reasonableness requirement' on a target board in determining what their fiduciary and statutory duties are, beyond requiring the target board to obtain external legal advice that failing to respond would likely breach those duties, was an unacceptable fetter in a fiduciary out clause.

As for the comments about the 'somewhat lengthy' exclusivity period, we remain of the view that, provided the agreement has appropriate fiduciary outs, the standard suite of exclusivity provisions is not anti-competitive and the period agreed in good faith by the parties to suit the circumstances of their transaction should not be subject to judicial review or comment. We are not aware of transaction agreements in our market which have been anti-competitive due to the period of their operation.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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