FRUSTRATING ACTION NOT UNACCEPTABLE

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Legal Briefings – By **Simon Haddy** and **Lily Zhang**

SUMMARY

- The Mungana Goldmines takeover bid provides some practical guidance on the steps that target boards can take to minimise the risk that an action which triggers a bid condition will not give rise to unacceptable circumstances.
- The transaction also provides an example of a situation where the 'blessing' of shareholders in respect of that frustrating action was obtained via statements of shareholder support, rather than at a formal shareholder meeting.

FRUSTRATING ACTION – A REFRESHER

The actions of Mungana Goldmines in its response to a hostile bid by Auctus Chillagoe provide an interesting example of the steps that target companies can take to ensure they do not fall foul of the Takeovers Panel's 'frustrating action' policy in its Guidance Note 12.

The Panel's policy can have a significant effect on target companies during a hostile takeover bid as, in general, material transactions and initiatives – no matter how attractive or value-accretive – cannot be implemented by the target company without approval from shareholders if they might cause a condition of the bid to be breached.

The Panel's policy, which stems from a 2001 decision of the Takeovers Panel relating to the takeover bid by Reliable Power for Pinnacle VRB, has ensured that target shareholders, rather than target boards, have the final say on whether a takeover bid succeeds.

Not all actions which breach bid conditions will give rise to unacceptable circumstances. The Panel will take a pragmatic approach and will consider commercial factors which may mean the action is not unacceptable, such as:

- factors surrounding the bid (eg how long the bid has been open, its likelihood of success, and whether the breached condition is commercially critical to the bid); and
- factors surrounding the frustrating action (eg whether the frustrating action was undertaken by the target in the ordinary course of its business, and whether the frustrating action materially affects the financial or business position of the target).

If frustrating action would *prima facie* be unacceptable, then this can be 'cured' by the target obtaining shareholder approval for the particular action – in other words, by putting back in shareholders' hands the decision as to whether a bid condition will be breached and the bid hence put in jeopardy.

THE MUNGANA SITUATION

In late April 2015, Auctus made an off-market takeover bid for Mungana at 13.5 cents cash per share.

The offer is highly conditional, with the bidder's statement containing around 30 conditions, including that Mungana must not:

- grant a right of mining or other rights or interests of any kind over any area covered by major tenements to any person other than a Mungana group entity; or
- issue shares or agree to issue shares, other than in the ordinary course of business.

In early May 2015, Mungana's directors recommended that shareholders reject the Auctus bid, asserting that it significantly undervalued Mungana and its prospects, and emphasising the bid's high level of conditionality.

Since Auctus announced its bid, Mungana's shares have traded above Auctus' bid price.

In late May 2015, Mungana announced two new initiatives, namely:

- a series of significant joint venture-style agreements with Newcrest Mining in relation to some of Mungana's major tenements; and

- a $5 million placement of shares to progress drilling and complete the feasibility study associated with certain projects.

Both these initiatives potentially breached conditions of Auctus' bid.

The placement – but not the Newcrest arrangement – is subject to Mungana shareholder approval at a general meeting.

In June 2015, Auctus made an application to the Takeovers Panel alleging that certain of Mungana's public disclosures were misleading and deceptive. The Panel dismissed that application, but Auctus has applied for review of that decision. However, Auctus did not, in that application, also allege that either of Mungana's two proposed initiatives (outlined above) breached the Panel's frustrating action policy.

THE APPROACH OF THE MUNGANA BOARD

Mungana announced that the decision of the Mungana board to enter into the Newcrest arrangements was made after 'careful consideration' of all relevant circumstances (including the fact that Auctus' offer may potentially lapse or be withdrawn as a result of its decisions).

In making its decision, the Mungana board believed entering into the Newcrest arrangements was in the best interests of Mungana's shareholders. Further, the board thought the offer conditions significantly restricted Mungana's ability to undertake certain corporate activities in the ordinary course of its business where such activities were considered to be in the best interests of shareholders. In particular, the board did not believe that the Newcrest arrangements were inconsistent with the commercial objectives of Auctus in making its offer.

The Mungana board also consulted with the company's two major shareholders (who together held over 70% of the Mungana's shares). These shareholders provided written confirmation that, on the basis of the current state of affairs, they would support any resolution to permit Mungana entering into the Newcrest arrangements, if a shareholders' meeting was to be convened to consider such a resolution.

The major shareholders also confirmed that they intended to vote in favour of any resolution to consider the proposed placement at a general meeting.

COMMENTARY

When faced with a course of action that may fall foul of the Panel's frustrating action policy, directors of target companies essentially need to ask three questions:

1. Does the relevant action constitute 'frustrating action' – ie would it actually breach a bid

condition?

2. If so, is the frustrating action likely to be ‘unacceptable’, bearing in mind the nature and status of the takeover bid and the likely effect of the frustrating action on the bid?

3. If so, what form of ‘blessing’ from shareholders is sufficient to allow the frustrating action to proceed?

In Mungana’s situation, the first question seems straightforward. *Prima facie*, both the Newcrest arrangements and the placement appear to constitute frustrating action.

The second question, however, is a little trickier, particularly in the case of the Newcrest arrangements. The Mungana board was at pains to explain why the course of action is reasonable in the circumstances, and why it should not – in substance – ‘frustrate’ the bid.

Having made out this argument, the board then built a second layer of protection by relying on the statements of support from majority shareholders (being statements which, under ASIC’s ‘truth in takeovers’ policy, the shareholders will be held to).

Obtaining such statements (if feasible in the circumstances) appears to be an appropriate way to address the third question posed above. The only issue is whether – having answered the second question – Mungana actually needed to obtain any shareholder blessing at all in order to implement the Newcrest arrangements.

In the case of the placement, the potential impact on Auctus’ bid was more acute. Additionally, the ASX Listing Rules expressly oblige a target to obtain shareholder approval to undertake placements during the three months after a bid is announced. For these reasons, the second question may not have been as easy to answer, and shareholder approval was likely to be required in any event.

Interestingly, Auctus has subsequently stated that it does not intend to treat the Newcrest arrangements as a breach of a bid condition. However, Auctus has reserved its right to treat the placement (should shareholder approval be obtained and the placement proceed) as a breach of a condition which would allow it to walk away from its bid. Whatever happens, it is Mungana’s shareholders who will have had the final say – and, ultimately, that is the aim of the Panel’s frustrating action policy.

LEGAL NOTICE
