Preface

Negotiated Acquisitions and Buyouts is a plain English reference guide for mergers and acquisitions and buyouts with step-by-step advice on the key legal, tax and structuring issues when implementing transactions. It is a comprehensive guide intended to assist professionals, investors, management teams and advisers and it gives detailed and up-to-date information on each stage of the deal and related areas. There are chapters on term sheets, shareholder arrangements, debt financing and due diligence. The book also considers the best approach to ensuring success in various specific deal types, including initial public offerings, employee share option plans, investing in roll-ups and distressed acquisitions. In each case the benefits and risks are considered and industry statistics included. The book is primarily focused on acquisitions and sales of private companies but also includes a chapter on public company takeovers.

The useful checklists, definitions, case studies and examples all contribute to making this an essential addition to the bookshelves of all those involved in acquisitions, divestments and private equity. Thoroughly researched and extensively verified, *Negotiated Acquisitions and Buyouts* has been reviewed by a panel of industry experts, including some of Australia's best known lawyers, investors, bankers and corporate advisers.

Nick Humphrey
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About the Author

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He works with some of Australia's leading private equity investors, including Macquarie Capital, Anacacia Capital, Helmsman Capital, The Growth Fund, Quadrant Private Equity and CHAMP Ventures, as well as advising on a broad range of complex corporate transactions.

Nick focuses on partnering with institutions and private equity funds (and their portfolios) and is very experienced in negotiating large and complex acquisitions, divestments and investments, including structuring share sales, negotiating shareholder and subscription agreements and conducting due diligence investigations. He has acted on some of Australia's highest profile deals including the sale of Gloria Jeans, Macquarie Capital's investment into 3P Learning (Mathletics), the sale of Diona Engineering to Calibre and CHAMP Ventures buyout of Lorna Jane.

Nick is the author of eight best-selling business books including the *Penguin Small Business Guide, The Business Startup Guide,* the *Australian Private Equity Handbook* and *Maverick Executive: Strategies for Driving Clarity, Effectiveness and Focus*. He has published numerous articles on private equity and M&A in the *Australian Private Equity and Venture Capital Journal* (AVCJ). These include "Responsible Investing", "Strategies for Private Equity Funds in Competitive Bid Situations", "Trends in Structuring Private Equity Deals Post GFC", "Key Issues in Insuring an M&A Deal", and "Key Structuring Issues in Industry Roll-ups".

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Nick is also the chairman of the Australian Growth Company Awards, a program launched in partnership with Deloitte, Westpac, Macquarie Bank and AVCAL in 2012 to recognise innovation, sustainability and integrity.

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CHAPTER 1

PRELIMINARY ISSUES IN M&A

Deciding on shares versus business purchase .... ¶1-010
Negotiating confidentiality undertakings .... ¶1-020
General issues in negotiating term sheets .... ¶1-030
Acquisition term sheet .... ¶1-040

This chapter considers some of the issues to be resolved by the parties early in the transaction.

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¶1-010 Deciding on shares versus business purchase

Buyers will need to decide whether to acquire the shares in the company or to acquire the underlying assets and business. Buying the shares in a company involves not only buying the business of the company but also taking on all its debts and liabilities.

The main factors to consider when deciding between buying the shares and buying the business are:

- How much stamp duty or goods and services tax (GST) is payable?
- Is warranty coverage adequate?
- Will financial assistance issues be manageable?
- What external consents are required?
- Will the process of offering new roles to employees be manageable?

How much stamp duty or GST is payable?

Buying shares generally incurs less stamp duty then buying assets. In general, shares can be transferred free of stamp duty in most states of Australia (except South Australia where 0.6% is payable) whereas the sale of assets may incur stamp duty on a sliding scale of between 1.5% and 5.5% (depending on the state where the assets are located). Note that purchases of shares in a company which owns land may be subject to a higher rate of duty.

It is important to understand that the asset sale could also be subject to GST, unless the business is being sold as a "going concern", and speaking to a qualified tax adviser about the potential stamp duty or GST payable in each transaction is recommended.

Is warranty coverage adequate?

The buyer will need to consider whether the warranty cover provided by the seller is adequate. If the buyer is concerned about coverage, it should consider whether to buy the assets rather than the shares. In buying the shares, the buyer inherits all the liabilities in the company (such as unpaid taxes, contingent liabilities, unsettled litigation, environmental degradation claims, etc).

A thorough due diligence will be useful in assessing the likelihood of undisclosed liabilities. However, where the risk of a claim is high (for example, where the company has done some "creative" tax management or has been involved in high-risk activities such as asbestos disposal) the buyer may wish to err on the side of caution and buy assets rather than shares. It is worth noting that not all liabilities can be avoided by simply buying the assets (for example, environmental liabilities accrue to the occupier of the premises, not just the owner).

Another option for obtaining stronger warranty coverage is to procure warranty and indemnity insurance. This is where an insurer provides a policy which covers any loss or claim arising upon a breach of the warranties or indemnities in the sale agreement. The premium will currently cost approximately 1% to 2% of the insured amount. This is covered in detail in Chapter 14 (Key Issues with Using W&I Insurance).

Will financial assistance issues be manageable?

A company is prohibited from providing financial assistance to a buyer of shares in itself or shares in its parent company.

Financial assistance can be given in a variety of ways, not just simply the lending of money to the buyer but also guaranteeing loans to the buyer's financiers or granting the buyer's financiers security, such as a fixed and floating charge. It could also be the payment of dividends at the time of sale (even if retained by the existing shareholders). The assistance can be provided before, during or even after the sale.

The main exemption from this prohibition is where the majority of shareholders in the company (and any upstream Australian parent company) provide their consent to the assistance. The Australasian Securities and Investment Commission (ASIC) must be notified at least 14 days before the assistance is to be provided.

In deals where time is of the essence then the parties may not be able to wait for this pre-approval process (for example, if the sale is highly confidential and a leak could be damaging to goodwill or if the target is in distress and needs urgent refinancing).

Shareholder approval also may not be easily forthcoming if, for example:

- the shareholders of the target are concerned about the high level of debt being used to acquire the company
- the shareholders in the upstream parent company are widely spread, overseas or disgruntled, or
- the ultimate parent is listed.

In these circumstances, where the financial assistance approval process, known as a "whitewash", proves to be too time-consuming or difficult to obtain, the buyer might be forced to make an asset purchase. Alternatively, the financiers may have to wait until after completion to implement their security package.

What external consents will be required?

In a business purchase, it is important to review each of the key contracts between the target and third parties such as its contracts with its landlords, customers and suppliers. These contracts will typically require that the counterparty to the contract provides its consent before the contract is assigned to the new buyer. In particular:

- **Leases**: These commonly require the prior written consent of the landlord before the lease can be assigned. In some businesses (such as retail chains) there may be a large number of leases. Some leases will require the new tenant to provide security for the lease in the form of bank guarantees, security deposits or a parent guarantee. This process will need to be managed efficiently in order to keep the deal timetable on track and minimise legal costs.
- **Government grants**: Buyers should be careful to check any grants, permits, licences, subsidies and whether there are assignment restrictions. For example, a government grant may be repayable if there is a business sale. Similarly, a permit or licence may require notice or prior consent before the sale.

If there are a large number of key contracts, the task of obtaining consent to assign the lease to the new buyer might be prohibitively expensive and time-consuming.

On the other hand, when buying shares, counterparty consents may not be required (as there is no actual change in the contracting party). During due diligence care will need to be taken that the material contracts do not have change of control provisions (which would in turn still require consent).

Will the process of offering new roles to employees be manageable?

As with third party contracts, buying the business will require entering into new contracts with all employees and any contractors. In contrast, when buying the company all those contracts remain in place (it is unusual to have a change of control in a service agreement, known as a golden parachute, but this should be verified in due diligence). Managing the process of drafting up offers to a large workforce can be quite time-consuming and can also make it hard to keep the deal confidential (while waiting for a week or so for the employees to consider, sign and return).

¶1-020 Negotiating confidentiality undertakings

It is common for a seller to require a buyer to enter into a confidentiality agreement or non-disclosure agreement (NDA). This will need to be signed and negotiated at an early stage of the deal and governs the use of confidential information made available to the buyer (which in the case of a private equity (PE) deal, is usually a new company formed to make the bid in the buyout (Newco) and the investor).

Advisers (such as lawyers and accountants) tend to resist entering into direct confidentiality undertakings and, as such, the onus will be on management, the buyers and the Newco to ensure their advisers observe the confidentiality undertakings. Advisers will, of course, have professional liability to their clients for any loss arising from a breach on their part.

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The management team members are not usually asked to sign an NDA, as they are typically already bound by confidentiality covenants under their service agreements.

Some of the common features of NDAs follow.

Disclosure: This prohibits the recipient from disclosing confidential information or using such information other than for the purpose of determining whether to proceed with the proposed deal. It may also prohibit disclosure of the *existence* of discussions or negotiations between the parties. Recipients should consider negotiating some important exceptions to the general prohibition, including for information:

- given to the recipient by a third party (that is not itself bound by a duty of confidentiality)
- which comes into the "public domain" (other than due to a breach by the recipient)
- that is developed by the recipient independently (without any use of the information supplied by the target)
- that the recipient can demonstrate was already in its possession
- which is otherwise required to be disclosed by law (eg Australian Securities Exchange (ASX) listing rules).

Copying: The copying of information or its reproduction onto a computer disc is prohibited.

Return or destruction: Most sellers require all confidential information to be returned if the deal does not proceed. The recipient should consider requesting permission to destroy the materials rather than return them. The seller may ask for a signed certificate to confirm that the information has been destroyed.

Permitted disclosures: The recipients should check that they are allowed to provide copies of the confidential information to their legal, accounting or other advisers. In some cases the NDA may also restrict which employees are allowed to access the information.

Poaching: The recipient is restricted from poaching any of the target's employees. These provisions are common where the recipient is a trade buyer, but where the recipient is a PE house the risk is diminished. Consider negotiating exceptions:

- where the recruitment occurs after a person has left the employ of the target (without enticement or encouragement from the recipient) and at least six or 12 months have expired, or
- for employees who accept an offer of employment via a bona fide advertisement (such as in a newspaper or online).

Indemnity: The agreement may include an indemnity in favour of the seller from any loss or claims arising as a result of a breach of the NDA.

Associates: It may be drafted on the basis that the relevant parties ensure that their employees, advisers and other representatives observe the undertakings.

Consequential loss: Recipients should consider including a clause which excludes consequential loss or indirect losses (such as loss of profit or opportunity) from its liability.

Sunset: Another issue is whether any or all of the covenants in the agreement should terminate after a certain period of time. For example, the non-poach covenant could have a 12-month sunset provision or alternatively all the covenants could lapse after a reasonable period (say, two or three years). Sellers are less likely to give sunset provisions to trade buyers or where the information contains highly sensitive materials such as secret recipes or processes.

Disclaimer: The NDA may also contain other provisions such as a disclaimer about the accuracy of information provided or a prohibition on contacting staff, customers or other stakeholders directly.

¶1-030 General issues in negotiating term sheets

This section considers the key issues in negotiating term sheets. Once agreed, the term sheets govern the proposed transaction until such time as the parties have negotiated the long form legal agreements. The commentary on acquisition term sheets does not apply to listed public companies or companies with more than 50 shareholders. Buyers are strongly advised to seek appropriate legal advice on the implications of Chapter 6 of the Corporations Act on such proposals.

Some issues which are common to all term sheets whether an acquisition term sheet discussed below or an equity investment terms sheet discussed in Chapter 7 (Preliminary Issues in Private Equity Transactions), include:

- What is a term sheet?
- Short form versus long form?
- Binding or non-binding?

What is a term sheet?

Term sheets are:

- relatively short form documents in which the parties summarise the key terms of their proposed relationship
- documents which, once signed, allow the parties to negotiate a formal legal agreement that sets out the detailed provisions of the deal
- known by various names including heads of agreement, memorandums of understanding, letters of intent or non-binding indicative offers
- useful for focusing the energies of the parties on the major issues early in the process, saving time and expense in drafting the formal agreements later.

Advice from suitably qualified lawyers is important to ensure that all the relevant areas are covered, and no inadvertent concessions are made which could frustrate future negotiations.

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Short form versus long form?

The term sheet is intended to summarise the principal terms only and not set out every term and condition. A short form term sheet is designed to establish the common intention of the parties to proceed with the transaction on several agreed metrics. It is important to ensure that negotiation of the term sheet does not become protracted or drawn-out. There is always the risk that the term sheet negotiation becomes a "dress rehearsal" for the main negotiation, thereby increasing costs and delaying the timetable (often at a time when due diligence has yet to be performed).

On the other hand, a long form document provides an opportunity to put forward some of the potentially more contentious issues (for example, in the equity term sheet the good/bad leaver provisions or in the acquisition terms sheet the warranty and indemnity limitation regime). By raising these issues at the outset, it minimises the risk that the other side feels ambushed down the track. It may also allow for a streamlining of the negotiation and documentation process at the formal agreement stage.

The key to the successful conclusion of a transaction starts with ensuring that the factors that might influence price or payment related terms are identified in the terms sheet. For example, cash v shares, post-closing adjustment mechanisms, warranty and retention reserves, earn-outs and deferred payment.

Binding or non-binding?

In most cases, term sheets are stated to be "non-binding" or indicative and "subject to formal legal contracts", the general intention being that the parties can walk away from the negotiations at any point.

It is important to note that even if the term sheet is not legally binding, it will be considered a "gentleman's agreement" and it will be difficult for a party to backtrack or raise significant new issues.

It is worth considering whether certain parts of the term sheet should be legally binding (in particular, covenants with respect to costs, confidentiality, break fees, obligations to negotiate in good faith, and exclusivity).

In some deals, term sheets are expressed to be legally binding. This would be the case where the parties need certainty that the deal is to proceed at an early stage (for example, to avoid risk of leakage to staff or a key customer). To be binding, however, the term sheet will need to contain a high degree of detail and certainty across almost all aspects of the transaction.

The courts have sometimes held a term sheet or offer letter to be legally binding, and have forced the parties to proceed to consummate the deal (even where the deal has been disadvantageous to one of the parties). To minimise the risk of the term sheet being held binding, include words such as:

> "The parties have not entered into any agreement to negotiate definitive documents pursuant to this term sheet. Either party may at any time prior to execution of definitive documents propose different terms to those contained in this term sheet or terminate negotiations pursuant to this term sheet without any liability to the other party."

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The term sheet may also form a binding "contract to negotiate" if it includes a provision requiring the parties to "negotiate legally binding contracts in good faith". This does not mean the parties actually have to enter into definitive contracts but that a party could be in breach if it refuses to negotiate or fails to negotiate in good faith (for example, raises uncommercial, onerous or non-customary terms).

¶1-040 Acquisition term sheet

This term sheet sets out the key terms of the acquisition. This may be prepared by the buyer or the seller. If a seller is running a competitive sale process, it will usually prepare the term sheet. If a buyer wishes to make an unsolicited offer, then it will usually prepare the term sheet. It is preferable in PE deals for investors to use their own template, as they get the "power of the pen" and that way there will be consistency in the terms of their acquisitions across their portfolio.

Some of the key terms:

Parties	The key parties to the transaction will usually be the sellers of the target, the buyer (in a PE deal this will include the investor and potentially also the management team). It is important to consider carefully who should be a party to the term sheet: ● If the sale is to be done by way of shares, then it is important to note that the target cannot bind the shareholders to sell their shares, so the buyer should ensure that the actual holders of all the shares are also parties to the term sheet. ● In a PE deal, the Newco will not usually be a party to the term sheet as it will probably not yet be formed at this early stage. Obviously, Newco would be the buyer and a party to any definitive sale agreement. ● If either the buyer or the seller is not an entity of substance (for example it is a nominee or merely a subsidiary of another holding company), then the upstream company or holding company may also be required to be a signatory. This may be to simply procure obligations on behalf of the buyer/seller or to actually guarantee the performance of the buyer/seller. ● It is also important to consider who will be giving the warranties and other covenants (particularly the restraint of trade covenants). It may not just be the entity which holds the shares, it could be the individuals who control the relevant entity. Consider also whether directors of the target (who may not hold shares) should give covenants.
Price	The price and any payment terms should be clearly set out, including: ● the currency payments will be made in, if it is a cross-border deal ● whether any of the consideration will be paid in shares ● details of any deferred consideration or earn-out ● details of any purchase price adjustment mechanisms, such as completion accounts, and ● whether any amounts are being paid into escrow, or otherwise being retained, and the proposed terms of their release.

Assumptions	The underlying financial assumptions on which the price was prepared must be included. This typically refers to working capital levels, minimum revenues or earnings, whether it is cash or debt-free and the level of net assets.
Conditions precedent	Buyers will typically require a number of conditions precedent to be satisfied before the purchase will proceed, including: ● finalisation of satisfactory due diligence ● receipt of internal approvals and third party consents (such as those from landlords and material customers and suppliers) ● regulatory approval (Foreign Investment Review Board (FIRB), Australian Competition and Consumer Commission (ACCC)) ● no material adverse change (MAC). (Sellers should consider what exclusions and carve-outs should be made to the MAC) ● consider industry specific requirements for industries such as alcohol and gaming, pharmaceuticals, mining, banking and financial services, healthcare, and aviation. Sellers will typically seek to have as few conditions as possible, other than to reluctantly accept due diligence and regulatory approval.
Timetable	The timetable to negotiate and conclude the transaction needs to be set out. This should take into account the timetable set out in the equity term sheet and also the exclusivity period, if any (see below). It will set milestones by which key activities need to be completed (such as finalising due diligence, signing legal documents, etc). The parties should try and agree a realistic timetable to avoid having to seek an extension at a later date.
Exclusivity	Buyers will be keen to have an exclusivity period, during which time the sellers agree to deal solely with that buyer and not negotiate with any third parties. Some issues to note: ● Exclusivity may not always be granted as part of the initial term sheet, particularly if there has been a high level of interest in the target from other bidders. Buyers should revisit the issue once the deal has progressed further, as sellers may be willing to grant exclusivity once they are satisfied as to the bona fides of the offer. ● Until exclusivity is granted, buyers are unlikely to spend money on advisers' fees or invest their own time into thorough due diligence. ● The term sheet should also consider what happens if the sellers receive approaches from third parties. Buyers may insist that they are informed of such approaches during the period of exclusivity. ● It may be prudent to regulate how the business is run during the exclusivity period, to ensure the business is conducted in the ordinary and usual course (for example, to avoid the risk of creditors being strung out or debtors being unduly harassed) and that no dividends or other distributions are made to shareholders.
Legal status	As discussed above, it should be clear whether it is intended for the term sheet to be binding or not. If not, ensure there is a provision that states it is not intended to be legally binding (other than exclusivity, confidentiality undertakings, break fees or any costs indemnity).

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<table>
<tr><td>Warranties and indemnification</td><td>Terms sheets rarely include specific warranties, other than to refer to "customary warranties for a transaction of this nature". However, as a seller, it is important to try and include "customary limitations" to the warranties, such as disclosure, caps and baskets, time limits and so on.</td></tr>
<tr><td>Restraint</td><td>The buyer should think carefully about who it may wish to impose a non-complete obligation on: should it be the seller, or should it extend to the shareholders of the seller.</td></tr>
<tr><td>Costs underwrite</td><td>Costs underwrites, also known as abort fees or break fees, are where one side agrees to pay the other side's costs and expenses if the deal does not proceed. Either side may ask for an abort fee and, whether it is given, will depend on each party's bargaining position. It may be that the parties agree to give mutual cost underwrites.
The potential arguments that may arise are:
<table>
<tr><th>Seller</th><th>Buyer</th></tr>
<tr><td>The seller will argue that by giving exclusivity to one bidder (particularly, in a competitive tender), it is losing the opportunity to sell to another third party. If the chosen buyer does not then complete the transaction, the seller will have incurred costs but not completed the sale and should therefore have its costs reimbursed.</td><td>The buyer will argue it is incurring significant costs, especially in relation to due diligence, in reliance on the assumption that the seller will proceed. If the seller withdraws from the deal, is unable to obtain approval from its board of shareholders, or breaches the exclusivity undertaking (by selling to a third party), then the buyer will want to recover its costs.</td></tr>
</table>
It is important to note that even if the term sheet does not include a break fee, a claim for costs can be brought for breach of the exclusivity undertaking if either side can prove it suffered a loss.
The events which trigger the break fee should be carefully set out, for example:
● the seller or Newco withdrawing from negotiations during the period of exclusivity
● the target's shareholders failing to approve the terms of the sale
● Newco reducing the offer price (other than as a result of material adverse due diligence finding).
The break fee provisions should cover adviser fees incurred on a contingency basis.
In an MBO, there is always a difficult issue as to who will actually bear the cost of a break fee payable to the sellers. The Newco will not actually have any assets and the managers will not wish to take on the significant personal liability for the seller's costs. Buyers will also be reluctant to pay the seller's costs as they will have already incurred their own costs. A potential compromise is that costs are limited to reasonable third party costs up to a pre-agreed cap.</td></tr>
<tr><td>Other</td><td>It will usually include other provisions such as confidentiality undertakings, disclosure exceptions, governing law, etc.</td></tr>
</table>

Sources

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CHAPTER 2

ACQUISITIONS AND BUYOUTS

SPAs ¶2-010
Strategies for tender sales ¶2-020
BPAs ¶2-030

This chapter looks at the acquisition process and focuses primarily on providing an overview of share purchase agreements (SPAs) with strategies for tender sales covered as well. However, key issues arising in a business purchase agreements (BPAs) are also considered.

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¶2-010 SPAs

This section provides an overview of SPAs, including:

- parties
- conditions precedent
- pre-completion covenants
- calculating the purchase price
- warranties, disclosure and limitations, and
- restraints of trade.

Parties

The parties to the SPA will be the shareholders of the target (as sellers) and the buyer. In a buyout scenario, the buyer will be Newco (being the company formed to act as the buyer, the shareholders of which will be the post-acquisition management team and the private equity (PE) investor — see Chapter 8 (Equity Funding)).

When on the buy-side, an investor will not usually be a party to the SPA as it will not want to have any direct liability. As Newco is unlikely to be an entity of substance prior to completion, sellers may well push for the investor to act as a guarantor of the Newco. This will depend on the investor's internal practices for giving guarantees but is generally resisted.

In a share sale, the target company is not usually a party, as the contract is one between the sellers and the Newco (who is buying the sellers' shares). Care needs to be taken where the target is a party as it cannot bind the shareholders to sell their shares and there may also be a prohibition on the company giving covenants under the SPA (which could amount to financial assistance).

If a seller is a nominee or a subsidiary of another holding company, then a buyer may insist that the upstream appointer or holding company also be a signatory to stand behind the warranties and other covenants given by the seller.

Where the deal is structured as a partial exit for the founders, or management are selling part or all of their existing shareholding, special issues arise. The buyer should seek warranties from those founders/managers that are selling but the value of those warranties is questionable. How realistic is it for an investor to pursue its own managers? To do so would disincentivise them and distract them from pushing the business forward.

Buyers should also consider who should give restraint of trade covenants. It may be prudent to not just get the entity which holds the shares but the individual who controls the relevant entity, associates of that individual and perhaps also key executives or directors of the target (who may not actually hold shares) to also give covenants. It might be hard to get these additional covenantors to sign up if they are not receiving share sale consideration or an ongoing participation post-completion and an additional payment may be required. From a legal perspective, where there is a concern that no "consideration" is given for the relevant covenants they should be included in separate deeds of restraint to overcome enforceability concerns.

Conditions precedent

The SPA will set out the conditions precedent to be satisfied before the purchase will proceed. These will mirror the term sheet plus additional matters which have arisen during due diligence including:

- **Regulatory approval**: Approval from competition or other authorities (such as the Australian Competition and Consumer Commission (ACCC) or the Foreign Investment Review Board (FIRB)) may be a requirement. If a regulatory condition needs to be satisfied prior to completion that condition will be incorporated in the SPA.

- **Due diligence**: Usually sellers will require the buyer to complete their due diligence before signing the SPA. If the timetable has not permitted this review then the buyer should ensure that the SPA is conditional upon finalisation of due diligence to their satisfaction.

- **Internal approvals**: Either side may have internal approvals which must be satisfied before the deal can be consummated, including in the case of Newco, the investment committee approval of the investor and in the case of the sellers, approval from its ultimate shareholders (which may be a requirement of listing rules if the seller is a listed company).

- **Third-party consent**: The material contracts of the target may require certain third-party consents (such as from landlords, suppliers and customers) to a change of control. Where those contracts are material to the target's business a buyer is likely to insist that obtaining those consents is a condition precedent to completion of the SPA.

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- **Material adverse change**: Particularly where the period between exchange and completion may be long or external debt is used to finance the acquisition buyers will look to include a provision that there has been no "material adverse change" (MAC) as a condition precedent to completion. Some of the key issues to consider are:
  - MAC provisions are usually drafted to cover a change in the financial position of the target prior to completion.
  - A "broad-based" MAC provision will be drafted to include a forward-looking element (such as no material adverse change in the "prospects" of the target or no occurrence of an event which "could reasonably be expected to" diminish the financial position of the target).
  - Broad-based MAC provisions are often required in those deals where external debt financing has been obtained to finance the acquisition. Buyers need to ensure they can back-to-back their "out" under the MAC in the sale agreement with that of the bank under its debt facility with the buyer (so in the event of a MAC they are not obliged to buy if the bank is not obliged to fund).
  - In strong seller markets or on competitive tender sales, buyers might expect to be required to take "financing" risk because sellers will expect not to have to accept any execution risk arising from the buyer's inability to finance the transaction.
  - It is worth bearing in mind that recent case law suggests that the "occurrence" of an event is not regarded as sufficient in itself; the buyer must factually establish that it had (or depending on the drafting of the MAC) is likely to have a material adverse effect on the target and possibly that such an event could not reasonably have been foreseen.

If any of the conditions precedent are still outstanding at exchange, then the SPA should provide for a period between exchange and completion to allow these conditions to be satisfied.

There should be a "sunset" date beyond which the SPA will terminate if the conditions have not been satisfied (or waived). Clearly the longer this period is, the greater the risk that the proposed sale will be leaked to customers, staff or the media (and the parties should be prepared to deal with questions from these stakeholders if there is a leak).

From the perspective of the buyer, it is important to minimise the number of conditions precedent (CPs) which are in favour of the sellers. It may be prudent to try and defer execution of the SPA until as many sell-side CPs as possible are satisfied.

If this is not possible, because the seller must obtain a regulatory approval or the approval of shareholders (eg if it is a listed company selling its main operating subsidiary) then the buyer should consider strategies for minimising the risk that this approval is not obtained or the impact of it not being obtained (consider a break fee or cost underwrite for example).

From the perspective of the seller, it will also be important to minimise any CPs as the Newco will have no financial capacity until it is funded by the investor and debt provider.

Pre-completion covenants

If completion is not simultaneous with exchange of contracts (usually to give the parties time to satisfy the conditions precedent), a buyer will be keen to guard against reductions in value of the target during that gap period over which it has little or no control of the target but at the end of which it may be obliged to acquire it.

In particular, during this gap period, there is a risk that sellers may neglect the business as they are distracted by the sale process (eg omit to renew a lease or roll over an insurance policy) or seek to strip out value (by deferring creditors, accelerating debtors, paying management fees or dividends). The sellers could also bind the target to onerous new contracts (such as new supply or customer arrangements on uncommercial terms).

The nature of this risk will depend on a multitude of factors including the length of the pre-completion period, the macro-economic environment and whether the gap period straddles key dates in the target's annual business cycle (eg bonus time for a professional services target or December/January for a retailer). Usually, the longer the period of delay the greater the risk the target business's value will be diminished.

Typically, the buyer will seek to mitigate this risk by keeping the gap period to a minimum and by incorporating the following gap provisions into the sale agreement:

- **Warranties**: The buyer may be able to obtain protection through the repetition of warranties given on exchange at completion (or all times down to completion). As with the warranties given on exchange, there are limitations to the protections such warranties provide: sellers may resist future claims by relying on the various limitations on warranties (eg arguing that in the case of a management buyout (MBO), the management team already had knowledge of the relevant event or circumstance). The *de minimis* regime might also mean that the value of any claim is too small to justify recovery.
- **Purchase price adjustment mechanisms**: If there is a completion account mechanism (discussed below), this will usually give the buyer additional protections against changes in value of the target prior to completion based on accounts drawn up as at the completion date after completion. If a locked box mechanism is employed (discussed below), the target is typically priced as at the date of the last accounts prior to exchange. Although the "no leakage" covenants will extend from the date of those accounts to completion, there will not be a true up based on the value of the target at completion.
- **Management team**: The investor may take comfort that in an MBO, the management team is already running the business on a day-to-day basis. The seller may refuse to give the pre-completion covenants in an MBO situation, on the basis that the managers will confer with the investor about operational issues. However, this should be done in a transparent manner (not simply pursuant to a side letter between the managers and the investor).

- **Covenants and undertakings**: The buyer will require the seller to give certain covenants and undertakings about how the target business will be conducted between exchange and completion. Generally, these provisions aim to ensure the value of the target and its assets is preserved and that the target business is run by the sellers as it would have been if no buyer was in the picture. Specific covenants will proscribe specific non-ordinary course activities (eg paying bonuses, dividends or altering the target's capital structure) or require that they may only be carried out with buyer consent. If a completion accounts price adjustment is used, the covenants may also be crafted so as to prevent the sellers from artificially inflating the target's value as at completion (eg prevent a manufacturing business from increasing its working capital by "stuffing the channels" of its suppliers). Typical covenants and undertakings include obligations on the seller to ensure:
  - the target's business will be carried on in the ordinary and usual course of business
  - the target will not issue new securities, vary the rights attaching to securities, declare or pay dividends or other distributions
  - the target will maintain insurance and otherwise protect assets
  - the sellers will ensure that the target will not, without the consent of the buyer:
    - enter into, vary or terminate material contracts (including employment contracts)
    - hire or fire key staff
    - commence material litigation
    - incur material capex.

Calculating the purchase price

The SPA should clearly set out the component parts of the purchase price for the sale securities, including the price per share and also the aggregate purchase price. If there are different classes of shares (such as ordinary shares and preference shares) or different classes of securities (such as options or loan notes), then the SPA should show the differential mechanics and prices for those classes. Consider (ultimately this will depend on the terms of the actual securities and the tax position of both sides) whether:

- preference shares in the issued capital of the targets are redeemed, converted into ordinary shares or transferred as are
- options are transferred for cash, swapped for options in Newco, exercised and the shares issued then sold, or cancelled (for a cash payment by the target)
- loan notes or subordinated shareholder loans are assigned or repaid (be careful here as the monies are owed by the target to the note holder and as such the repayment would need to be by the target).

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The payment mechanics should be specified, including whether by telegraphic transfer or bank cheque. If the purchase price is specified in a foreign currency, the SPA needs to manage carefully the timing and basis of any conversions (eg the calculation back into A$ will be done as at 5.00 pm on the business day prior to completion, using the rate published on *Bloombergs* or in *Australian Financial Review*).

Note in relation to cross-border transactions — if the bidder is paying in a foreign currency, then the bidder should consider hedging the purchase price, and if the seller is receiving foreign currency consideration, then the seller should consider hedging the sale proceeds. This should be considered initially from when the contracts are exchanged until the transaction settlement date to lock in the purchase/sale price, and thereafter as appropriate for the business's ongoing foreign currency cash-flows.

Warranties, limitations and disclosure

What are warranties?

The SPA will contain a number of "warranties" from the sellers. Warranties are statements of fact that the seller makes and upon which the buyer relies. They serve a dual purpose: first they force disclosure of information that a buyer needs to inform its appraisal of the value of the target and second, if they are proven to be incorrect after the target is purchased, the buyer may be able to sue the seller to recover part, or all, of the purchase price. Warranties will cover a broad range of issues, such as:

- that the financial statements are properly prepared in accordance with accounting standards and represent a true and accurate depiction of the business as at the reference accounts date (these will be the locked box accounts if a locked box mechanism is employed, see Chapter 3 (Purchase Price Adjustments))
- material or non-ordinary course events since the reference accounts date
- that the seller owns all the business assets, free of any third-party interests (eg the computers are owned outright and are not subject to a hire purchase arrangement)
- that no litigation has been commenced or is pending against the business.

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Warranty limitations

The sellers will seek to minimise their exposure under the warranties by including "limitations" in the SPA (which will ultimately depend on the respective bargaining power of the parties) such as:

- **Claim periods**: The SPA will usually specify a time limit for bringing a claim under the warranties:
  - for tax-related claims, this period is ordinarily between five and seven years from completion
  - for non-tax warranties, it is customary to allow the buyer at least one or preferably two audit cycles. In general, this equates to 12–24 months from completion
  - for core warranties (like title, power and authority), there may be a longer period of, say, 36 months
  - it is worth noting that in competitive deals, the sellers may insist on shorter claim periods (in some cases as short as six to nine months).
- **Threshold**: The sellers will not be liable for a warranty claim unless the liability exceeds a threshold, both for individual claims and/or for claims in aggregate (known as the "basket"). Some of the key issues with baskets follow:
  - Size of basket: This will vary from deal to deal. Typically 1% of the purchase price but can often be as high as 2% (particularly in large deals or where there was a competitive tender sale). Usually, the basket is more likely to be in the range of 0.5% to 1.5%.
  - Per claim basket: The per claim threshold will also vary from deal to deal, usually it is 10% of the aggregate basket but from a buyer's perspective the per claim threshold should be as low as possible to ensure there is not an artificial hurdle to bringing a claim (as long as the per claim threshold is not so low that the buyers can "nickel and dime" the sellers over very small amounts).
  - Tipping point or first dollar: The question here is what happens to the claims up to the threshold amount, if the buyer recovers the entire claim (this will be a "first dollar" threshold), whereas if they can only recover the excess, this is known as a tipping point (so the buyer will have to be at risk for claims up to the aggregate amount, similar to, say the excess in an insurance policy).
  - Exclusions: The buyer should seek to exclude from these baskets certain types of claims including those arising from the fraud or wilful non-disclosure of the sellers' claims relating to tax or other "core" warranties (title to the sale shares or authority to sell).
- **Cap on claims**: The seller will seek to cap its liability to the buyer for a breach of warranties. Points to be taken into consideration are:
  - Typically, the cap agreed can vary from as low as 10% to 100% of the purchase price.
  - In Australia, it is reasonably common for the cap to be set at the purchase price, unless it is a competitive deal where tax and other core warranties might be set at, say, 80% to 100% of the purchase price but with other warranties at 20% to 50%.
  - There should be a provision which states that these caps do not apply where the claim relates to fraud or wilful non-disclosure by the sellers.
  - It should be considered whether the cap should be increased to account for any debt assumed or repaid as part of the deal.
  - Increasingly, sellers are making use of warranty and indemnity (W&I) insurance as a way of minimising or absolving themselves entirely of the risk of claims under the warranties. As a market, Australia was an early adopter of such policies and still has one of the world's more developed W&I insurance markets, see Chapter 14 (Key Issues with Using W&I Insurance).

- **Change to accounting practices**: The sellers may ask for a limitation to exclude claims which would not have arisen "but for" a change in the accounting practices adopted by the buyer post-completion. Before agreeing to this limitation the buyer should consider whether there should be exceptions where it needs to make changes to:
  - comply with existing laws, International Financial Reporting Standards (IFRS) or generally accepted accounting principles (GAAP), or
  - the accounts to reflect that it is now a stand-alone entity and not part of a group (eg what was immaterial in the context of a large group may be important to a smaller entity).
- **Provisions in the accounts**: The sellers may also seek a limitation for claims to the extent that there has been provision or reserve in either the audited accounts or the completion accounts. The standard of such provision is important; the buyer should ensure it was specific and express, to minimise the risk of the sellers seeking an unintended shield.
- **Knowledge of the buyer**: The sellers may also seek to exclude claims for a breach of warranties where the buyer has knowledge of the relevant fact or matter of circumstance giving rise to the claim. In an MBO, this will be complicated by the fact that the management team has been involved in the operations of the target. Some sellers may go further and seek a limitation based on what management "ought reasonably to know". It is preferable to restrict such provisions to the actual knowledge of the management team and expressly exclude implied knowledge.
- **Knowledge of the seller**: It is common for the sellers to seek to qualify some of the warranties to the extent of their knowledge, usually by adding the words "so far as the seller is aware" to the relevant warranty. A corollary to the issue discussed above with respect to the buyer's knowledge is whether the seller's knowledge is actual or deemed (eg the knowledge they ought to have had if they made reasonable enquiries or due and careful enquiry). The buyer should resist an overarching provision that all warranties are subject to knowledge — generally if a liability arose while the sellers owned the business, it should be to their account (it happened on "their watch" and they should not be able to avoid the risk because they were not aware of it). In an MBO situation, the sellers will probably argue that there are areas which they cannot warrant absolutely.

In an MBO, the sellers are likely to offer limited warranty cover on the basis that the management team has a far better knowledge of potential liabilities and other matters facing the business. They might argue that the managers will have built these factors into the purchase price already and Newco should not be able to seek further protection for risks it has already priced in through a warranty claim.

From the perspective of the buyers, they should still seek warranties to cover those areas with which management has had little or no involvement. In particular, they may have had limited involvement in group-level activities, such as preparing the accounts, the tax, insurance, intellectual property or superannuation aspects of the business.

Also, what is the risk that the sellers, on behalf of the target business, entered into any binding contracts without management's knowledge?

Lastly, the buyers should ensure and include a requirement in the SPA that any entity providing warranties is of substance and will have sufficient funding available for the duration of the claim period to meet any warranty claims that may arise. Again, W&I insurance may help bridge any funding gap, see Chapter 14 (Key Issues with Using W&I Insurance).

Disclosure

Disclosure is the procedure by which sellers qualify the warranties where the factual circumstances do not accord with any one or more of the warranted statements made. The scope and terms of the disclosure clause are negotiated between the seller and the buyer. The buyer will be keen to ensure that the warranties given in the acquisition agreement are not completely negated by general disclosures made whereas the seller will seek to include as many disclosures, as broadly as possible.

The SPA will usually specify the level of disclosure required, such as "full, fair and accurate" disclosure or "fair" disclosure. In practice, what constitutes adequate or fair disclosure will depend on the circumstances of the transaction, including the nature and materiality of the matter disclosed and the manner in which the information was provided to the buyer. It is not enough simply to refer to the source of information. The seller may need to make a specific disclosure with some detail of the relevant matter before it can constitute a "fair" disclosure and draw attention to the relevant document (preferably the relevant clauses) in the drafting of the specific disclosure.

The buyer should be asking the seller to quantify matters which are disclosed in the disclosure letter including an estimate of the potential liability which might arise from the relevant matter.

In an MBO, not only will Newco normally be expected to accept wider limitations but it will often be under pressure to accept disclosure on a broader basis than in a trade sale. Not only will the sellers be reluctant to warrant matters within the management team's knowledge, but will be wary of putting themselves in a situation where the qualification of a warranty is by disclosure based on information provided by the new management of the buyer.

Restraints of trade

In general, these covenants in an SPA can be more restrictive than restraints in an executive service contract. The parties should seek advice from a qualified lawyer on the terms of these provisions to ensure they are not held by a court as being unenforceable (eg are the provisions reasonably necessary to protect the legitimate interests of the buyer/target? Are they void for being too uncertain?). The courts are generally reluctant to prevent an employee from making a living using the skills they have gained through experience or study. That said, they recognise that it is unfair for an employee or director to gain a springboard from using a company's client lists or secret information.

Non-compete: The SPA will include a provision which restricts the sellers and their associates from competing against the target business in a specific region for a specified period (say three years) after completion.

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Non-solicitation: Newco should prevent the seller from soliciting key employees, customers, distributors and suppliers. To maximise the enforceability of this provision, careful consideration needs to be given when extending the protection beyond one to those employees and customers with whom the seller/target has had contact during the period of the seller's ownership.

Confidential information: Newco should clearly and adequately identify all confidential information to be restricted from disclosure. The restriction does not need to be for a specific period but should no longer apply if the information becomes available to the public (other than by reason of a breach of the confidentiality undertaking given by the seller).

¶2-020 Strategies for tender sales

Competitive bids are now commonplace as a means of selling a business, particularly when the seller has engaged an adviser to run the process (which is over 40% of the time in US mid-cap deals). A private treaty sale where a buyout fund has an exclusive mandate from the outset is becoming less common. With a growing focus on corporate governance and director's duties, vendors are keen to ensure they secure the best price and terms for the business and an auction is a demonstrable means of doing so.

The process outlined above (particularly the fact that exclusivity is not granted until late in the process) causes significant problems for most PE funds:

- **Cost tolerance**: There are significant costs for any bidder inherent in participating in an auction process. Given the PE funding model, these costs are more difficult for investors to tolerate than their trade buyer competitors. Not only are there tax, accounting and legal costs (including negotiating an SPA or BPA and conducting due diligence) but there is also the internal executive time required. PE funds are simply not as cost and time tolerant as a trade buyer — in part because their performance fees are return-on-investment (ROI) driven but also because funds are significantly more active than a corporate. A trade buyer can bury the costs of one failed bid every year or two and may also have more internal resources to throw at due diligence. It is harder for a fund which is doing them every few months and has a small in-house team.
- **Access to management**: Competitive bids are time intensive for the management team at the seller. If the fund is running an MBO, the board of the seller may restrict interaction between the fund and its new management team. This makes it harder for the fund not only to form a bond with that team but also to get the time to negotiate the internal structures with management.
- **Conforming bid**: It may be difficult for a fund to lodge a conforming bid. The bid will often have to be conditional on closing the external debt funding and also on finalising the bid company structure with management.

Another important issue to note is that while PE funds are renowned for wanting to pay the lowest price, there are ancillary benefits from including an MBO option. For many vendors (especially foreign companies) it is important to have a "walk-in/walk-out" sale (with minimal risk of warranty claims or workplace tensions). This is more

likely to happen with a sale to a PE-backed management team given its existing knowledge of the business and existing relationships with staff.

A potential way of minimising these tensions for a PE fund is for sellers to grant a break fee. The seller can run the process with two preferred bidders up to or as close as possible to an unconditional SPA having agreed to reimburse the loser with its reasonable costs incurred. This maximises competitive tension but minimises the costs to bidders of an unsuccessful bid.

What is a break fee?

A "break fee" is a fee promised by the seller to a bidder which becomes payable if the bidder does not succeed in the deal.

The break fee payable is generally equivalent to the costs incurred by the bidder. In the US, however, break fees on bids involving unlisted entities can be as high as 3% or 4%.

As a general rule, the further into the due diligence process bidders are asked to go without exclusivity, the more reasonable it is to request compensation in the form of break fees in the event of being the unsuccessful bidder. By leveraging exclusivity against risk coverage in this way, bidders gain some protection. For a detailed discussion of break fees, including their regulation by the Australian Takeovers Panel, see Chapter 13 (Selling the Portfolio Company).

Managing the auction process

- **Focused and staged due diligence**: In the auction process, it is critical for buyers to carefully scope the due diligence to be undertaken. It is also important to set realistic materiality levels before due diligence is commenced (if they are set too low, the team can get distracted and costs may blow out). In most cases, it is also possible to stage due diligence. Early on, due diligence must be focused on investigating any high strategic risks of the company (in that way buyers can pull out of the bidding process if they come across any major problems).
- **Process**: It is important that the bidder clarifies with the seller the process early in the transaction. Part of the "poker game" is to understand how flexible the seller really is in terms of the meaning of "final bid". For example, can the bid be conditional on debt finance? Does the bidder really have to lodge a marked-up version of the SPA and so on?
- **Lodgement of SPA**: As discussed above some sellers state that a conforming bid must include a marked-up version of the SPA. Bidders should consider, however, whether they simply lodge an issues paper with their bid in an effort to minimise legal expenses if they are unsuccessful but, more importantly, to keep their options open on the terms of the SPA if they are successful.
- **Exclusivity**: The key will be to negotiate exclusivity as soon as possible in the process. Sellers will be reluctant to do this, as once a bidder is exclusive the power balance swings in its favour and it will try and reopen the price and claw back some of the terms.

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- **Cost sharing**: In addition to negotiating a break fee, bidders may be able to convince the seller to produce, at their own cost, vendor due diligence reports (eg engaging a third party to perform a phase one environmental report, or seller's legal, tax and accounting advisers to prepare legal, tax and accounting reports).

It is generally considered that the competitive tension generated by an auction maximises the potential sales price and secures the most favourable terms for sellers. However, PE funds may simply refuse to participate in an auction process (due to cost intolerance) or be unable to participate (the complexities of an MBO mean that the fund cannot lodge a conforming bid in the specified timetable). As such sellers are narrowing their pool of potential bidders by running a strict "final binding bid" process. The granting of break fees would appear to be a win/win for both sellers and PE funds. It gives the seller competitive tension throughout the whole process (as they do not need to grant exclusivity) but gives the fund some downside protection.

¶2-030 BPAs

This section discusses key issues in BPAs including:

- preliminary matters
- identifying assets
- specifying liabilities
- novating and assigning contracts, and
- employees.

Preliminary matters

Why purchase a business?

Some reasons buyers prefer business purchase transactions include:

- **Cherry pick**: a desire to pick which assets to buy and which to leave behind
- **Liabilities**: being reluctant to buy a company "as is" with all of its debts and liabilities (including unknown liabilities)
- **Buying a division**: deciding to only invest in part of an existing business (eg the distributor in a supply chain), leaving the seller to own and run the rest of the business
- **Step-up**: wanting the ability to "step-up" the value of assets for tax purposes, namely to value the asset at a higher market value upon purchase instead of at its original value
- **Tax reasons**: reluctance to buy a company with partially or fully depreciated assets (the seller may have already depreciated the assets as an expense on the company's previous income tax returns, leaving little or no depreciation for the buyer in the future)
- **Concessions**: a desire to be eligible for the full tax or government programme benefits by purchasing only the assets of the business (a company may have already taken advantage of all tax benefits or government programmes).

Parties

The sale is usually set out in a business or asset purchase agreement (BPA). It is important to clearly identify the seller of the assets, and the legal entity buying those assets.

It is important to identify who will be providing the warranties and indemnities. If a seller company is liquidated or deregistered after the sale, it may be necessary to seek warranties from key individuals or related bodies corporate with the resources to remedy a warranty claim.

Identifying assets

It is crucial to properly identify the assets to be acquired. Only assets and liabilities which are specifically identified in the BPA are transferred to the buyer. Assets not specified are not transferred. Below are typical categories that make up the going concern of the business.

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Categories of assets comprising the going concern
Plant and equipment
Property (lease)
Stock-in-trade
Work-in-progress
Goodwill
Intellectual property (trademarks, designs, patents, copyright)
Business name
Know-how and customer lists
Employees
Trade debtors

Plant and equipment: This refers to fixed assets whether attached to property (fixtures) or not (chattels). Equipment is tangible property (which is not land or buildings) used in the business and refers to, for example, vehicles, machinery, devices and tools. A buyer should clearly itemise all the plant and equipment it wants to purchase and consider how value is apportioned for income tax, capital gains, stamp duty and other liabilities.

If the seller leases equipment then these leases should be assigned to the buyer. During due diligence, the buyer should review the leases and check whether they require the financier's consent. A buyer should also ask for warranties that plant and equipment are in good repair and working condition at the date of signing and that this will be maintained by the seller until completion.

A buyer could consider confirming whether existing warranties and guarantees are attached to certain plant and equipment (eg vehicles) and whether the buyer can rely on such warranties and guarantees. If so, the buyer may ask for the existing warranties and guarantees to be expressly assigned to it.

Property: The considerations relating to freehold and leasehold property in a business purchase will be similar to those in a share purchase. The buyer will want secure tenure and will want to confirm that there are no defects in the lease, that any options

to renew are enforceable and that leases are binding on mortgagees. A buyer should not assume a lease without the mortgagee's consent. Failing to obtain consent is a breach of the mortgage, entitling the mortgagee to exercise its powers under the default provisions and recover possession of the property from the lessee as the lease is not binding on the mortgagee. Typically, the seller pays the lessor and mortgagee's legal costs when assigning the lease and the buyer pays for registering the lease and for stamp duty. If a new lease is entered into, the buyer usually pays all the costs, however, some sellers may pay if the buyer insists on obtaining secure tenure before sale.

Stock-in-trade: This is the product of the business and can include raw materials, work-in-progress and fully manufactured goods for sale. The parties should be as clear as possible when calculating or agreeing the method of valuing stock and work-in-progress. Doing this poorly could render the valuation method uncertain, incorrect or unenforceable. To avoid this outcome, the parties may wish to get a professional to value the stock.

Goodwill: Goodwill is essential to a purchaser wishing to maintain the business's past profits and grow profits in the future. Goodwill can be attributed to intangible personal property and can be characterised as local or personal goodwill. Goodwill is sometimes described as the value of business minus the value of net tangible assets.

Fundamental to the sale of goodwill is that the buyer obtains the benefit of existing and prospective customers and clients of the business. The buyer will also want an introduction to customers and to be assigned the customer list and records and ensure that the seller maintains trading and goodwill between signing and completion.

The buyer should identify the specific rights to vest in the buyer to adequately get the benefit of customers and maintain turnover and profit (eg by assigning the rights, assets and business name to the buyer and by preventing the seller from depreciating these rights (perhaps by restraining the seller from trading in a specified area for a specified time, for example)). As discussed, the buyer will then want to restrain the seller from competing with it and also restrain directors, key employees and certain shareholders.

Intellectual property: Trademarks, designs, patents and copyright should also be assigned to the buyer as goodwill can be attached to these items. A buyer should consider whether they want to use the seller's business name going forward. The parties will want to consider how much goodwill to apportion to intellectual property as, depending on the situation, this could lead to a favourable tax outcome.

Trade debtors: Parties should consider whether they also want to assign trade debtors and must consider the stamp duty implications of doing this. Another option is to allow the seller to retain the debtors pre-completion (however, a process for allocating any debts which are collected post-completion would also need to be agreed to minimise any disputes). The buyer may also want to prevent the seller from demanding, claiming or litigating against old clients for non-payment to avoid aggravating the buyer's new client and compromising the buyer's goodwill with them.

Purchase price apportionment

Setting the purchase price is important and the parties will have competing interests in how it is allocated to reduce that party's tax liabilities on the transfer. The specific amounts apportioned to goodwill, plant, equipment, stock, etc, will be negotiated depending on the interests of the buyer and seller.

Although stamp duty on goodwill and trading stock has been abolished in most states, parties should confirm whether this applies in the jurisdiction of the transfer. Some buyers may seek to apportion some goodwill to intellectual property to reduce stamp duty, however buyers should note that they have to be able to justify that the apportionment is reasonable. If the taxation authorities choose to scrutinise the apportionment and calculate a greater dutiable portion, a party may be liable to pay duty on the higher calculation. The price apportioned to plant on which a seller claims depreciation is important, as is the value of equipment for which the seller claims depreciation and capital gains tax.

Specifying liabilities

The buyer may assume responsibility for some seller creditors and liabilities as part of the transaction. For example, the buyer may assume the seller's debts to its suppliers, employees and to certain clients for performance of goods under warranties, pending litigation, or liabilities to service providers.

Typically, however, a buyer will want to exclude all liabilities which relate to the period before completion. If a liability becomes known after completion, the seller may in some cases be able to recover from the buyer. A seller may want to have comfort that this will not happen by persuading creditors to release the seller and consent to the buyer assuming the seller's place by, for example, a novation or assignment.

Novating or assigning contracts

Business contracts to which the seller is a party do not continue automatically after the acquisition. It is critical that key contracts can be assigned or novated so the buyer has the benefit of these after completion. Buyers may have to enter into a new contract in some cases and whether they do this, assign or novate will depend on the business needs of the buyer.

The buyer has to decide whether they want to accept the seller's liability from the start of the contract by way of a novation or if they will be assuming liabilities from completion. All parties will need to consent to the novation.

Seeking consent can lead to significant work, cost and risk for the buyer. Buyers should confirm that the rights attached to assets they are buying are not personal to the seller, as these cannot be assigned.

Some examples of contracts that may be novated or assigned include contracts involving business relationships, including software or intellectual property (IP) licenses, supplier, transport, advertising, distributor and plant- and equipment-lease contracts. If rights and obligations cannot be assigned or novated, then a new contract may have to be entered into by the parties.

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- **Insurance**: Another important way to bridge the warranty gap in a secondary buyout is through the use of warranty and indemnity (W&I) insurance. If the new investor secures a buy-side policy, it can recover from the insurer for any breach of warranties.
- **Specific indemnities/escrow**: If there is a material potential liability, claim or risk which the buyer can identify during due diligence, they can seek:
  - **Purchase price reduction**: If the risk is significantly certain or material then a dollar-for-dollar reduction in the price could be negotiated or perhaps a deferral of that portion of the consideration until such time as that risk can be ascertained or settled.
  - **Specific indemnity**: All or some of the vendors give a specific indemnity (notwithstanding the buyer has knowledge of the risk, claim or liability) for that risk from the sellers as an alternative to general warranties from the PE vendors.
  - **Escrow**: All or some of the vendors deposit a portion of the sale proceeds into an escrow account for a set period of time. This escrow can be used as "retention" against all warranties or certain specific indemnities only. If W&I insurance is being used, the policy may only cover claims over this escrow/retention.

Most vendors would prefer to agree an indemnity or escrow as opposed to the price being reduced.

It is worth bearing in mind that when the secondary buyout completes, the company will have been subjected to rigorous due diligence not once but twice. Also, a business which has been owned by PE is more likely to have had internal governance than a private family-owned one.

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CHAPTER 11

KEY STRUCTURING ISSUES IN INDUSTRY ROLL-UPS

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Risk mitigation strategies . . . . ¶11-040
Empirical evidence . . . . ¶11-050

There have been many high-profile industry consolidations or roll-ups in the last decade which have created significant shareholder value such as Fone Zone, Kids Campus and Medical Imaging Australia. However, as powerful as the roll-up strategy is, it is not suited to all industries and there are significant execution and integration risks, as demonstrated by recent failures such as Stockfords, Harts and ABC Learning Centres. This chapter provides an overview of the key issues associated with roll-ups and their success or otherwise.

¶11-010 Introduction to roll-ups

In simple terms, a roll-up involves the integration of a large number of small businesses in the same industry to create one large company. Roll-ups are generally suited to large and highly fragmented "cottage industries" with strong cash flows but without a dominant player.

Usually a "sponsor" (sometimes backed by a private equity (PE) fund) establishes a new entity (a "platform") to acquire the other companies ("bolt-ons") with the objective of generating economies of scale and reducing costs through standardisation.

There has been a number of high-profile PE backed roll-ups. Below are some examples of these, showing company name, investor and internal rate of return (IRR) on exit:

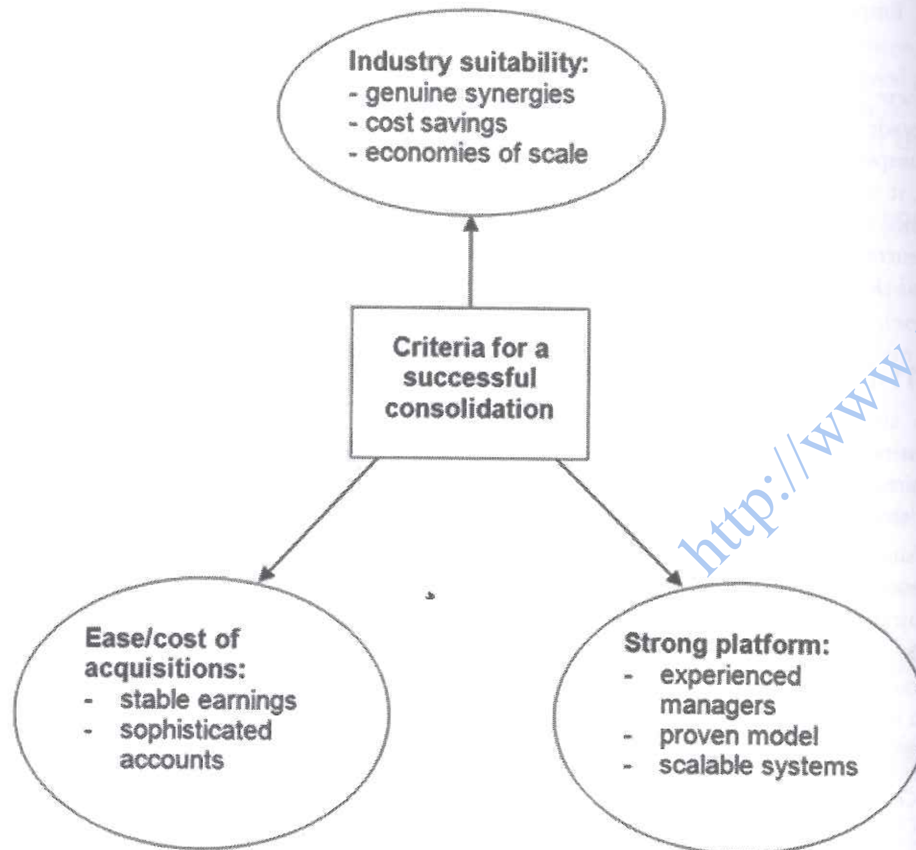
Company	Investor	IRR
Commander Communications	RMB	140%
Fone Zone Group	Investec	>100%
Hastie Group	RMB	90%
InvoCare	Macquarie Direct	51%
Kids Campus	Investec	N/A
Taverner Hotel Group	Catalyst Advent	25%

Company	Investor	IRR
Vision Group Holdings	AMP Capital	45%
Rubicor Group	ANZ Private Equity	>40%

¶11-020 Criteria for success

To maximise the likelihood of success, the following questions should be considered:

- Is the industry suitable for consolidation?
- Has the ease and cost of acquisitions been determined?
- Does the "host" business constitute a strong platform?
- What is the optimal size for the roll-up (how many bolt-ons should be acquired)?
- Does the platform have access to sufficient committed capital to achieve the desired size?



Is the industry suitable for consolidation?

It is important to consider industry dynamics both pre- and post-consolidation. The implementation of a roll-up is likely to change the competitive landscape, sometimes dramatically. How will other competitors react to the aggregation? Will customers see the consolidation as beneficial?

According to LEK Consulting[1] when determining whether an industry is suitable for consolidation, the following should be considered:

- Is the total size of the industry big enough to generate economies of scale? For example, with funeral homes, economies could be generated through centralised bulk purchasing of caskets or flowers.
- Will consolidation generate cost synergies? For example, with veterinary services, standardised operating and pricing policies could simplify procedures and reduce customer uncertainty.
- If the customer interface represents a high percentage of the costs, the opportunity for economies of scale is limited (for example, in the dry-cleaning business).

Some industries stay highly fragmented for good reason — not all sectors are suitable for consolidation. There need to be genuine synergies and real cost savings or revenue enhancement to justify consolidation.

Some businesses benefit from being small, innovative and localised. They may have values which are not always enhanced by size (and hence are businesses less suitable for consolidation). For example, a boutique hotel attracts customers by being "unique", not commoditised. Service businesses may be less suitable for consolidation as there is a risk that as soon as restraints are finished the service providers will leave and set up a competing business.

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Has the ease and cost of acquisitions been determined?

Another important element of a successful roll-up is the ease and cost of acquisitions. The professional costs of acquisition, including legal, accounting, tax and strategic due diligence can be significant. Due diligence might be prohibitively expensive when buying businesses with a high risk of contingent liabilities, complex financial histories or uncertain/unstable forecasts. In many regulated industries, such as healthcare, the efficiencies of centralised regulatory compliance and management may to some extent be outweighed by the costs of regulatory due diligence and change of ownership or similar applications.

Does the "host" business constitute a strong platform?

A key criterion for success would appear to be that the "host" or "platform" has:

- an experienced management team
- a sound and proven business model
- well-developed and scalable systems and infrastructure, and
- access to capital.

Trying to bring together a large number of equally small and unsophisticated companies is far less likely to succeed, without a strong host or platform business with a proven track record. The host will not only serve as a "hub" for operations, but will also demonstrate to other targets what can be achieved with the right systems and form a yardstick for assessing targets.

1 See Peter McKelvey, LEK Consulting "The Ties that Bind in Roll-up Plays that Work" (May/June 1999) 33/6 *Mergers & Acquisitions: The Dealmaker's Journal* 1.

Rick Giovannelli, a corporate partner at K&L Gates in the United States, has emphasised the importance of ensuring the platform has access to sufficient capital before embarking on a roll-up strategy, stating that "many roll-up strategies falter due to a lack of capital to continue acquiring additional bolt-on targets, especially if there are any operational hiccups in the early stages of acquiring and integrating the first generation of bolt-ons".

What is the optimal size for the roll-up (how many bolt-ons should be acquired)?

Trying to buy too many bolt-ons is risky. It makes it harder to integrate the diverse businesses, systems and cultures of the targets. It might also push up market multiples by increasing demand. The issue of how many bolt-ons should be acquired will depend on a number of factors:

- Growing too quickly restricts the ability of management to integrate the existing bolt-ons (both operationally and culturally).
- Not acquiring enough bolt-ons may fail to give the scale needed to utilise cost synergies and buying power, and offset the costs of the centralised platform management.
- To achieve exit through an initial public offering (IPO) requires a minimum market capitalisation of more than, say, $75m to $100m (to justify costs of listing, shareholder spread and analyst coverage, etc).
- It is easier to integrate a large number of small retail outlets or service businesses than larger and more complex businesses (such as manufacturing).

¶11-030 Advantages and disadvantages

Benefits of roll-ups

An often touted benefit of consolidation is the ability to arbitrage the difference in earnings multiples between private and public companies. In other words, small private companies can be acquired for a lower earnings multiple than a publicly listed company. The sponsor can generally acquire a number of small companies for, say, three and a half or four times earnings before interest, taxes, depreciation or amortisation (EBITDA) and then undertake a public offering or sale of the platform at seven or eight times EBITDA. The higher multiple is achievable due to the liquidity and transparency (due to audited accounts and continuous disclosure) of public markets. Even in a trade sale to a larger sponsor or strategic buyer, the earnings multiples often increase directly with the size of the target due to similar factors as well as the professionalisation of the management of the platform.

In addition to the earnings multiple arbitrage, some of the benefits that consolidation may generate include:

- **Cost synergies**: Cheaper insurance, merchant fees and buying power for stock can all be benefits.
- **Revenue synergies**: These can include cross-selling of products and services and introducing large clients into other regions.
- **Brand**: Superior brand recognition is likely to result.
- **Capital**: Access to (cheaper) capital is an ancillary benefit of not only the scale of the consolidated group but of PE backing.
- **Leveraging fixed costs**: Fixed costs (such as maintaining a head office and sales and marketing costs) can be spread over a large revenue base.
- **Corporatisation**: The introduction of a head office with access to more sophisticated information technology (IT) and accounting systems, for example, will free up time for the founders to get on with their business (rather than spending all their time doing administration, chasing bad debtors or paying bills).
- **Succession**: Many small business owners lack natural succession plans and the roll-up provides them with a future retirement plan.

The importance of these benefits will differ considerably between industries.

Disadvantages of roll-ups

On the downside, consolidation usually brings enormous integration difficulties, clashes of culture/ego, and execution risk:

- **Integration risk**: It will be difficult to integrate the different businesses acquired as they will all have different systems (including IT, accounting and business systems), management styles and cultures. The more companies acquired the greater the effort required to integrate and the higher the risk of integration failure.
- **Increased costs**: Sometimes the cost synergies do not outweigh the additional costs of a head office (such as salaries and lease expenses).
- **Non-alignment of incentives**: Once the founders have received a large cash payout as part of the roll-up, they lose focus and become distracted by their new-found wealth (concentrating on decisions about which super fund to invest in and what holiday house to buy) rather than focusing on driving their business forward. Many sponsors will seek to mitigate this risk by requiring sponsors to rollover some of their proceeds into the equity of the platform, but that approach often exacerbates the integration risk and cultural issues from having "too many chiefs". In some recent deals, there have been cases where the founder has actually left the group to start a new competing business.

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- **Cultural issues**: Often the targeted bolt-ons are run very informally with little or no corporate governance mechanisms in place and with limited finance or reporting systems. Under the new platform regime they will inevitably be forced to deal with a more formalised culture with far stricter reporting requirements and governance.
- **Execution risk**: This risk should not be underestimated and applies at both the acquisition stage and eventual exit stage. The greater the number of counterparties to be negotiated with means the greater the risk that the deal will not go ahead, and also increases the risk of "greenmailing" where one stakeholder seeks to hold up the consolidation or the eventual exit by relying on some technical right (in other words, refusing to sign the relevant acquisition or sale documents) to get a special deal.
- **Legal risks**: Roll-ups present complex structuring and legal issues which have a significant impact on the likely success of the integration. If the stakeholder arrangements are poorly planned there is a risk of unworkable corporate governance or susceptibility to greenmail as noted above. If the target shareholders are offered scrip in the platform company, there may quickly be a large number of shareholders. When embarking on a roll-up there are a number of issues which need to be carefully navigated through:
  - Prospectus rules: Consider whether a prospectus is required when offering shares — the rules on disclosure documents apply to private companies as well. There are a number of exemptions, such as fewer than 20 offers in 12 months to raise no more than $2m (20 in 12), minimum subscription of $500,000 or the "senior manager" exemption. A common misconception is that executive shareholders of targets will qualify under the senior manager exemption but this will need to be carefully considered (at the time of the merger the executives are not yet part of the staff).
  - Takeover rules: Another misconception is that the takeover rules only apply to listed companies. Care needs to be taken here as the rules also apply to private companies with more than 50 members. What this means is that investors or other material shareholders would need to comply with the takeover scheme rules or other exemptions before acquiring or increasing their holding in the platform company.

Some examples of failed roll-ups have been in the accounting services area. Both Harts Australasia and Stockford attempted to consolidate accounting firms. After a period of rapid consolidation, both companies were placed into liquidation. The most likely cause of this failure would appear to be forcing previously small independent practitioners to work under a corporatised structure with all strategic decisions being dictated at board level so, according to Tom McKaskill:

> "few of them would be able to participate but all of them would have to abide by the decisions."[2]

2 Tom McKaskill "Unite and Conquer" (2 March 2006) *Business Review Weekly*.

¶11-040 Risk mitigation strategies

The risks outlined above can be mitigated through the careful implementation of these strategies:

Risk	Strategy
Clash of personalities	Use a governance model that is founder-centric (for example, the founders retain a majority of the equity, the CEO is appointed by the founders and the majority of the board is appointed by the founders). See ¶11-050 for empirical evidence which suggests this governance model is an important driver of success.
Clash of culture	Use a "push" rather than "pull" strategy for new policies and procedures. In other words, leave it up to each founder whether they accept certain policies rather than forcing them upon them.
Execution risk	To minimise "deal risk", if possible use one lawyer for all bolt-ons, use a standardised set of legal documents for all bolt-ons and the same acquisition model for all bolt-ons.
Integration risk	Consider whether a decentralised (or federation) model is appropriate rather than a centralised structure. While it makes sense to integrate/centralise certain aspects of the business (such as corporate governance, financial controls/reporting and management of future acquisitions), full integration is not always necessary.
Alignment of incentives	Another issue is aligning incentives for vendors to stay involved with the business into the IPO and beyond. This will be a combination of "carrot and stick". The "carrot" will be options over additional equity or cash bonuses based on the performance of their original business (not just the group) and the "stick" will be: ● long-dated restraints of trade for say three to five years ● deferred consideration conditional on meeting earnings targets ● rights of set-off for deferred consideration against warranty claims ● "good/bad leaver" provisions ● escrow over shares to apply during the restraint and also for a period post any IPO ● minimised upfront cash payments to vendors (to say 20% of total).
Greenmailing	Ensure the shareholders' agreement includes a "drag-along" clause, so that if a bona fide third-party offer is accepted by a majority of shareholders (say 75%), any minorities can be "dragged" into the sale. It is important to ensure that there is a power of attorney in place to enforce the drag-along and it must be clear that the third-party offer can include scrip in the offerer (not just cash).

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Risk	Strategy
Legal risks	Ensure there are well-documented shareholders' agreements in place and that appropriate legal advice is taken on structuring to manage the prospectus and takeover rules issues.

¶11-050 Empirical evidence

The research paper by Keith Brown, Amy Dittmar and Henri Servaes provides some interesting empirical evidence about roll-ups.[3] They undertook a study of 47 roll-ups which listed in the United States over the five-year period to 1998. The study found:

- long-run stock performance (from initial listing to 1999) is more than 60 percentage points higher when the majority of the directors come from the founding companies
- post-IPO organisational structure of the companies was unstable (with 55% of CEOs and/or chairpersons changing)
- 11% of the companies entered financial distress and 17% become a defendant in a shareholder suit
- there is no evidence that the long-term stock price depends on the number of companies included in the *original* roll-up plan and no indication that "first mover" provides an advantage.

Are industry roll-ups a good idea?

Industry consolidations create opportunities to create significant shareholder value. They are, however, not without significant complexity and risk, such as integration problems, execution risk and stakeholder alignment concerns. These risks can be mitigated through the implementation of key strategies and structures, such as ensuring vendor interests are aligned with the ongoing business (including vendor-centric governance and long-dated restraints), "push" rather than "pull" cultures and the use of de-centralised management structures.

Sources

Keith Brown, Amy Dittmar, Henri Servaes "Roll-ups: Performance and Incentives for Industry Consolidating IPOs" (March 2001).

Nicholas Humphrey "Key Structuring Issues in Industry Roll-ups" (December 2006) *Australian Private Equity and Venture Capital Journal* 33.

Tom McKaskill "Unite and Conquer" (2 March 2006) *Business Review Weekly*.

Peter McKelvey, LEK Consulting "The Ties that Bind in Roll-up Plays that Work" (May/June 1999) 33/6 *Mergers & Acquisitions: The Dealmaker's Journal* 1.

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3 Keith Brown, Amy Dittmar, Henri Servaes "Roll-ups: Performance and Incentives for Industry Consolidating IPOs" (March 2001).

CHAPTER 12

RESPONSIBLE INVESTING AND ESG ISSUES

What are ESG issues and responsible investing? . . . . ¶12-010
Why is considering ESG factors important? . . . . ¶12-020
Formulating an ESG investment policy . . . . ¶12-030
Implementing the policy . . . . ¶12-040
United Nations-backed PRI . . . . ¶12-050

There is increasing interest by limited partners (LPs) and regulators in ensuring that private equity (PE) funds are "responsible investors" and consider environmental, social and governance (ESG) matters. This chapter considers the importance of ESG and strategies for implementing appropriate policies.

¶12-010 What are ESG issues and responsible investing?

Definitions

Considering ESG factors requires investors to focus not only on value creation but also to be "active owners" and manage the impact of their portfolio companies on the environment (such as pollution or energy usage), consider social issues (such as anti-corruption, workplace safety or labour conditions) and governance issues generally (such as independent directors and staggered boards).[1]

Environmental, social and governance issues		
Environmental	Social	Governance
● Animal welfare	● Bribery and corruption	● Cumulative voting
● Biodiversity	● Human rights	● Dual-class share structure
● Climate change	● Labour standards	● Executive compensation
● Cost of carbon	● Community relations	● Majority voting
● Ecosystem change	● Discrimination and harassment	● Poison pills
● Environmental liability	● Diversity (employment and board)	● Separation of chairperson and CEO
● Hazardous waste disposal/clean-up	● Living wage disputes	● Independent directors

1 CFA Institute *Environmental, Social and Governance Factors at Listed Companies: A Manual for Investors* (May 2008) CFA Institute Publications <www.cfapubs.org/toc/ccb/2008/2008/2>.

Environmental, social and governance issues		
Environmental	**Social**	**Governance**
● Pollution	● Predatory spending ● Political contributions ● Political hot-spots	● Shareholder rights ● Staggered boards ● Takeover defences

Some of the other frequently used definitions are:

- **Responsible investment (RI)**: This encompasses an investment philosophy focused on maximising long-term risk-adjusted returns. By integrating ESG considerations into the investment process, it will ensure that both investors and their portfolio companies will outperform in the long term as they are minimising risk and maximising the efficient use of resources. It does *not* include philanthropic investing or charitable donations nor does it include social ventures (where the primary goal is a social policy objective not long-term financial returns).
- **Corporate social responsibility (CSR)**: Phrases such as "corporate citizenship" or "corporate responsibility" generally cover the same issues. CSR applies to corporates, whereas the term "RI" applies to investors. CSR ensures that the long-term strategy includes focus on stakeholders other than just shareholders (including employees and consumers) and factors in non-financial issues that can positively or negatively impact on the development of the business.
- **Ethical investing**: A policy followed by investors who apply a negative or ethical screen to their investment process so they will not invest into:
  - certain sectors such as gambling or arms manufacturing, or
  - certain regions such as Burma (often linked to international treaties or conventions).
- **Social ventures**: This applies to investments into businesses where the primary goal is a social objective (such as finding employment for the homeless).
- **PRI** or **UNPRI**: Both of these refer to the United Nations endorsed Principles for Responsible Investment.

While there is an overlap in these different definitions, there is a spectrum of investing where the driving influence at one end is primarily financial returns and at the other end primarily social goals:

Social	< Spectrum of driving influences >[2]			Financial
Philanthropic investment	*Social ventures*	*Ethical investing*	*Thematic investing*	*Responsible investing*
Charity or giving away money.	Achieving social objectives through investing.	Ethical drivers prevail at expense of returns.	Investing into sectors where growth driven by public policy.	Long-term risk-adjusted returns to be maximised by factoring ESG.

2 Adapted from Tom Rotherham "Environmental, Social and Governance Factors: De-risking the Portfolio" (presented at AVCAL Bootcamp, 18 March 2011).

¶12-020 Why is considering ESG factors important?

Historically, PE fund managers were driven primarily by the desire to maximise returns to their LPs. Now there is a more holistic requirement and many investors are factoring ESG considerations into their investment strategies. At the very least, funds are assessing compliance with regulations and mitigating ESG risks, but in some cases investors are leveraging a strategic advantage from managing ESG issues.

A 2015 joint report published by the PRI, United Nations Environment Programme Finance Initiative (UNEP FI), UNEP Inquiry and UN Global Compact which was based on an analysis of investor practice and legal frameworks in eight countries, including Australia, concluded that, far from being a barrier, fiduciary duty creates positive duties on investors to integrate ESG issues, to mitigate risk and identify investment opportunities.[3]

Some potential factors explain the increase in ESG awareness:

- **Reputational issues**: There have been a number of high-profile PE funds who have been criticised by the media for their involvement in portfolio companies with questionable ethical practices (including the use of child labour to make clothing).
- **Legal/regulatory requirements**: Investors are being required to consider ESG issues to ensure they comply with evolving policy, legal and regulatory requirements in various jurisdictions. Australia already has complex legislation dealing with environmental issues, workplace management and occupational health and safety (OHS). Climate change policy has dominated the press for the last few years and in the United Kingdom there is already legislation which holds investors liable for the carbon emissions of their controlled portfolio companies.
- **LP requirements**: Some influential overseas LPs are requiring PE fund managers to meet ESG criteria as a condition of receiving investment from the LPs into the fund.
- **Voluntary standards**: There are now voluntary standards, which fund managers can abide by to implement their ESG responsibilities, including UNPRI, which are considered in detail at ¶12-050. In summary, the UNPRI provide a "voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices and so better align their objectives with those of society at large".[4] Other industry associations have also published responsible investing guidelines, including:
  - Private Equity Growth Capital Council (PEGCC)
  - European Private Equity and Venture Capital Association (EVCA)

3 Rory Sullivan, Will Martindale, Elodie Feller and Anna Bordon "Fiduciary Duty in the 21st Century" (2015) <www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf>.

4 Principles for Responsible Investment "About us" (2012) <www.unpri.org/about/>.

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- British Venture Capital Association (BVCA)
- Institutional Limited Partners Association (ILPA)
- Australian Private Equity and Venture Capital Association Limited (AVCAL).

- **Global financial crisis (GFC):** The GFC has impacted public and stakeholder trust in funds and highlighted ethical gaps in the financial services sector. Rebuilding trust has become a key priority for investors.

Consequences of failure

Failure to comply with ESG requirements can have significant adverse impact on the reputation of portfolio companies and also the fund manager. Failure to manage ESG issues can also create costs in the form of significant fines and penalties from regulators (in some cases OHS and environmental breaches are levied on the individual directors not just the company) and perhaps the revocation of funding from LPs.

Non-compliance with ESG requirements by an investee can have other direct and indirect costs as well, such as lost productivity due to strikes by a disgruntled labour force, lost production due to a manufacturing plant being shut down after an accident or clean-up time for waste spills and contamination.

Benefits of compliance

Some potential benefits include:

- creating new business opportunities, cost savings and operational efficiencies
- improving access to new markets and customers
- improving the saleability and value of an investee on exit. A survey by AVCAL in November 2009, found that 68% of respondents agreed that ESG issues can impact on exits
- driving product innovation
- attracting additional capital from LPs into the funds managed by the general partners (GPs).

A 2013 report "IMPACT — Australia: Investment for social *and* economic benefit"[5] reported on the development of "Responsible Investment", which they call "Impact Investment", in Australia. It suggests that impact investing activity is growing in Australia and that such investments have arisen where circumstances, need, energy and opportunity have coincided. Impact Investing Australia's website contains useful reports and research for impact investors. They also offer grants of up to $100,000 to help support the launch of impact investment funds. See www.impactinvesting australia.com.

5 "IMPACT — Australia: Investment for social *and* economic benefit" (March 2013) <www.docs.employment.gov.au/system/files/doc/other/impact-australia_nov_2013_2.pdf>.

Public scrutiny

It is worth noting that the bigger the fund manager and the bigger the size of its investees, the higher the expectations that it will be a responsible investor. Small funds doing venture start-ups or expansion deals are likely to be dealing with relatively small domestic businesses, which employ a small number of employees. Conversely, large funds are dealing with multinational investees, employing large numbers of employees and are likely to attract adverse publicity for ESG issues and are also more likely to be targeted by regulators for investigation.

¶12-030 Formulating an ESG investment policy

Some of the key factors to consider when formulating an ESG investment policy are set out below:

- **Why is the GP implementing an ESG investment policy?** Is it based on ethical beliefs, to manage regulatory/compliance risk, to create business opportunities and/or to manage the requirements of its own LPs?
- **Does the policy cover the portfolio companies only or the management entity as well?** This will need to be carefully considered, as some stakeholders will expect the manager to be ESG-compliant as well.
- **What are the minimum standards required by LPs?** Some LPs are quite strict on ESG principles (and require regular reporting of compliance) and prohibit GPs from investing in certain countries or regions (which might have a history of human rights violations or child labour) or certain industries such as tobacco, gambling or weapons manufacturing.
- **Does the GP have adequate resources to implement the policy?** For smaller funds it might be worth focusing the ESG policy on high-risk issues rather than trying to comprehensively manage all three "pillars" of ESG. It might be better to focus on a sub-set of issues rather than trying to tackle all aspects of ESG.
- **Does the GP have the influence to implement an ESG policy in its portfolio?** Realistically, as a minority investor, it might be difficult to influence the portfolio company sufficiently to implement a strict ESG policy. Minority investors might seek to encourage the consideration of ESG factors at board level but, without majority control, it may be hard to enforce.
- **Is the GP investing into high-risk industries or regions?** If the GP is investing into portfolio companies which are in high-risk industries (such as chemical manufacturing or mining) or regions, then the policy will be more important. Clearly some industries have a greater inherent ESG risk profile. Consider the following examples:
  - Software business: low risk with potential issues limited to energy efficiencies and employee rights

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- Chemical manufacturing: higher risk and will raise a range of environmental risks including waste/noise/energy; social issues, such as OHS; regulatory compliance, such as permits for chemical storage, and Environmental Protection Authority (EPA) licences to discharge

- Clothing manufacturing: potential risk — for example, if the portfolio company is importing clothes from overseas, is there a risk of child labour? If manufactured locally, what are trade union relations like?

Example of an ESG policy

ABC Private Equity is committed to investing responsibly. We will encourage our employees and our portfolio companies to manage the impact they have on the environment and society. In particular, ABC Private Equity is committed to the following core principles:

- **Environment**: We will have a responsible approach to the environment. We will develop services and products which are environmentally friendly and help combat climate change. We will promote the management of natural resources and ensure our businesses are sustainable. We will monitor and facilitate compliance with all applicable environmental laws.

- **Anti-corruption**: We will manage our portfolio to ensure we avoid corruption, bribery and extortion. We will also comply with money-laundering regulations in each relevant jurisdiction where our businesses trade.

- **Workplace rights/human rights**: We will monitor compliance with workplace laws and encourage policies of anti-discrimination. We will ensure that our portfolio companies and, to the extent practicable, their supply partners are free from forced labour and child labour. We will protect the right to "freedom of association". We will avoid complicity in human rights violations and respect the International Bill of Human Rights.

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¶12-040 Implementing the policy

Implementing an ESG policy successfully involves a number of processes:

- **Integration**: Integrating the ESG policy requires it to be incorporated into the firm's investment and due diligence policies and needs buy-in from the key investment personnel and the portfolio company management and board. It will not be enough to simply allocate one investor director or the general counsel with an additional ESG compliance role — it needs to be a top-down goal for the firm. There must be support from the senior management, with the policy linked into the investors' overall objectives.

- **Screening**: Many funds already include ESG factors in the due diligence review, primarily targeting compliance with applicable regulations. Some investors also undertake the following:

  - **Negative screening**: This can be incorporated into the investment process to ensure the fund does not invest money into certain targeted sectors from an ethical perspective (such as tobacco, gambling, alcohol, mining and arms manufacturing) or regions (such as third-world countries or countries currently subject to sanctions by the UN Security Council).

  - **Positive screening**: Some investors target investment opportunities in cleantech or greentech or other sectors which contribute to public policy agendas, such as healthcare, water management or education. This positive screening is also known as "thematic investing" — in other words the investors focus on businesses which provide goods or services based around certain policy themes. In a way these policies focus on "needs" more than "wants" and investing in these areas is safer as they are supported by government policy and are really the industries of the future.

Sectors for thematic investment	
Environmental	**Social**
Energy efficiency	Healthcare
Sustainability	Safety
Environmental services	Social finance (access to housing)
Clean energy	Knowledge
Water management	Aged care

- **Due diligence**: When conducting an ESG review, consider:

  - **Overview**: A key focus of the ESG review is to ensure the investor clearly understands the potential risks, for example regulatory compliance track record, scope for potential environmental risks like hazardous chemical or waste storage and contamination as well as social issues such as employee relations.

  - **Risk perspective**: As discussed above, these risks will be magnified depending upon the size of operations, the location of operations and the type of operations. ESG issues will not be material for all companies but a decision which factors in ESG considerations will be better.

  - **Policy**: Investors should consider how changes in public perception and policy will impact on the investee in the future (both challenges and opportunities). For example, how will increasing water scarcity, an aging population or the climate change agenda impact on the business?

  - **Existing policy**: Part of the due diligence review will be to understand whether the target has itself adopted an ESG or CSR policy and an assessment of the executive team's awareness of the reputational and regulatory risks of non-compliance.

- **Track record**: A target (or sector) having a poor ESG track record does not always mean a "no go" decision — rather it can create a significant opportunity to improve reputation and marketability of the target, enhance customer and staff loyalty, and reduce compliance costs.
- **Value chain**: All aspects of the "value chain" should be considered when assessing the ESG risks. For example, for a manufacturing business, each stage of the value chain could be analysed as raw materials are converted into finished goods, packaged and then transported to the end user.
- **Investment presentation**: The investment team should include a section in the investment presentation which covers the ESG risks, mitigants and an assessment of their materiality.
- **Specialists**: The team can consider outsourcing the ESG due diligence to specialists if the perceived risks are high or the team lacks appropriate bandwidth or skills.
- **Checklists**: The due diligence checklists will need to be amended to include an ESG section of questions.
- **Focus**: One member of the team should be made responsible for the ESG component of the commercial due diligence and should ensure that a section is included in the investment proposal in an objective way (ie not just that there is an ESG risk but how it will impact on costs and profitability).

- **Post-deal considerations**: Once the investment has been made, the GP will need to continue to monitor the investee and ensure ongoing compliance with the ESG policy. The team will need to keep abreast of changes in regulation and ensure the policy evolves with the new laws. Also, recommendations arising from the due diligence review should be included in the 100-day plan for the company or its ongoing business plan. It is fairly common for investors to "file away" the due diligence recommendations, so it will be important that they are re-considered post-deal.
- **Reporting**: The investor needs to ensure the investee is aware of its ESG objectives and may even require the management team to report back regularly as part of the management accounts. Regular reporting is becoming more common in overseas jurisdictions and may even be a requirement of the LPs' commitment to the GP that ongoing monitoring and reporting is made.

  To the extent that there is a serious breach of an ESG policy at the investee level (such as an environmental disaster), the LPs will need to be briefed urgently to ensure they can respond to any media issues promptly.

  Consideration should be given to the timing and nature of information that will be disclosed to shareholders, regulators and other stakeholders (eg annual reports only or quarterly updates). Once the targeted reporting "outputs" have been determined, the required reporting "inputs" can be planned so that key performance metrics can be collated.

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GPs may also consider providing information to a wider group of stakeholders about their ESG activities including employees, customers and government.

The ILPA publishes reporting guidelines which have been updated to include ESG factors and require GPs to include information on material ESG risks and how they are being managed (including the reputational risks).

¶12-050 United Nations-backed PRI

As discussed at ¶12-020, the United Nations-backed Principles for Responsible Investment Initiative (PRI) is a voluntary program designed by the investment community. It was formed in 2006 with 65 signatories. The initiative has experienced huge growth and as at July 2016, there were 1,538 members across 61 countries. The membership is made up of investment managers (66%), asset owners (20%) and service providers (14%)[6]. Collectively, they represent US$59 trillion in assets.[7]

The PRI sets out six Principles for Responsible Investment:

> "1 We will incorporate ESG issues into investment analysis and decision-making processes.
> 2 We will be active owners and incorporate ESG issues into our ownership policies and practices.
> 3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.
> 4 We will promote acceptance and implementation of the Principles within the investment industry.
> 5 We will work together to enhance our effectiveness in implementing the Principles.
> 6 We will each report on our activities and progress towards implementing the Principles."[8]

The first three principles relate to "enlightened self-interest" whereas the others are essentially about shifting the market.

The PRI publication *Responsible Investing in Private Equity*, published in June 2011, states:

> "The UN-backed Principles for Responsible Investment (PRI) is a framework to help investors build environmental, social and corporate governance (ESG) issues into their investment process, to improve long-term returns and create more sustainable markets."

6 <www.unpri.org>.

7 "Fiduciary Duty in the 21st Century, Scoping Paper 2016–2018" (February 2016) <www.unpri.org/download_report/6091>.

8 Principles for Responsible Investment "The Principles for Responsible Investment" (2006) <www.unpri.org/about/the-six-principles>.

The PRI website contains a number of useful publications and other information to assist in adopting the principles. Extracted below are some guidelines for putting the principles into practice:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes

Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry

Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration
- Support regulatory or policy developments that enable implementation of the Principles.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives.

Principle 6: We will each report on our activities and progress towards implementing the Principles

Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a "comply or explain" approach (which requires signatories to report on how they implement the Principles, or provide an explanation where they do not comply with them)
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders.

Visit <www.unpri.org> for more information.

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Sources

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CHAPTER 13

SELLING THE PORTFOLIO COMPANY

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Pros and cons for the seller . . . . . ¶13-020
Vendor due diligence . . . . . ¶13-030
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A properly run sale process can help private equity (PE) funds achieve the best price and more favourable terms for their portfolio investee companies by creating better competitive tension. This chapter sets out the tender sale process (also known as a private auction) and considers some of the key issues for the project management of the process.

¶13-010 Overview of the typical tender sale process

The tender sale process varies between each transaction, but generally involves the following phases:

- **Flyer:** The seller distributes a confidential flyer to prospective buyers (which may include other PE groups) describing the business for sale.
- **Information memorandum (IM):** On executing a confidentiality agreement, interested prospective bidders are issued with an IM, which summarises the key strategic business financial information relevant to a potential buyer. It also includes the "rules" of the process.
- **Expressions of interest (EOI):** Prospective bidders are invited to lodge non-binding EOI that include an indicative non-binding offer. A deadline for lodgement is set by the seller. The bidders base their EOI on their review of the IM and their independent research, as bidders are not generally permitted to conduct formal due diligence at this stage. There may be some access to the management team of the target in this first stage under a controlled environment where it is thought to enhance the prospects of a sale.

- **Shortlist of bidders:** The seller and its advisers review the EOI and reduce the number of bidders (generally within the seller's range of selling prices), with the aim of maintaining competitive tension while keeping the group manageable through the remainder of the process. From a risk perspective, the greater the number of participants, the greater the risk that news of the sale will be leaked to the press or a broader group of management, customers, suppliers and staff, which may cause disruption to the seller's business and potentially reputation.

- **Due diligence:** Bidders are then invited to conduct formal due diligence and are provided with a draft share purchase agreement (SPA). During the due diligence phase, an online virtual data room (VDR) is typically kept open and the seller's management team will give presentations on the business and answer bidders' questions. The use of vendor due diligence (VDD) is now a standard protocol on most PE divestments. Further commentary on this is outlined at ¶13-030.

- **Binding bids:** The seller invites the bidders to make definitive binding bids. Generally, the seller will require binding bids to be unconditional, in particular as to due diligence and finance. A conforming bid will often require bidders to lodge a full mark-up of the SPA.

- **Execution of SPA:** Finally, the board of the seller selects a successful bidder and the SPA is negotiated and signed.

- **Variations:** Within this general framework there are many possible variations. To maintain competitive pressure, sellers may:
  - require several rounds of revised indicative bids
  - continue to negotiate with two bidders right up until the SPA is signed
  - run an initial public offering (IPO) process in parallel.

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¶13-020 Pros and cons for the seller

Advantages	Disadvantages
Maximises competition: The auction process maximises competitive tension between the bidders and generally ensures the best possible price for the seller.	Price discount: Bidders may discount their bid price to: ● provide protection against perceived risks arising out of the limited time and information available for due diligence ● reflect the fact that the terms of the SPA favour the seller relative to a private treaty transaction.

Advantages	Disadvantages
Information control: The seller controls the due diligence process to restrict the amount and type of data disclosed to bidders. The seller may actually withhold critical information until the final phases of the process, usually on the basis that it is highly commercially sensitive (such as schedules of prices or critical supply contracts). Further, confidential negotiation and due diligence are far less disruptive to the target business as the bidders are generally prohibited from approaching customers, shareholders and employees, who might otherwise become anxious about the sale.	Reluctant bidders: Since the likelihood of the bid succeeding is lower (compared to a sale via a private treaty deal) and bidders must expend significant time and money to participate in the process: ● some potential bidders will simply refuse to participate (thus reducing the potential pool of buyers) ● some bidders will only participate if they are granted exclusivity or a break fee early on.
Time control: The seller controls the timetable and will often force bidders to move through the due diligence and negotiation process much faster than they would otherwise. A VDR with a limited open time helps maintain the pace.	Retrading risk: A key risk for sellers is that after exclusivity is granted, the bidder re-opens negotiations on price and/or key terms (known as "retrading risk"). To minimise this risk, some sellers require a conforming bid to include a signed version of the SPA, or they run two bidders all the way through the process. The "two finalists" route is demanding and expensive for all concerned and some bidders may be unwilling to participate.
Pressure on bidders: The competitive process discourages bidders from amending the SPA unless the changes are fundamental to their bid. The seller can play off bidders against each other when negotiating the SPA, delaying commitment to any particular bidder until key terms have been agreed.	Limited market: A tender sale is not suitable in all cases, particularly where there are few potential bidders.
VDR — access to information: The use of VDRs allows sellers to engage a potentially unlimited number of bidders from around the world in the due diligence process. VDRs allow sellers to control and monitor bidder access to documents, permitting exclusion of failed bidders and wider access to short-listed bidders, often at a lower cost than a physical data room.	Higher cost: In a tender sale, the seller will be responsible for providing multiple bidders with access to due diligence material and responding to their queries. Costs escalate when a seller's legal representatives and financial advisers negotiate with more than one bidder, particularly with respect to the SPA.

Advantages	Disadvantages
Directors' duties: Obtaining a fair and reasonable price for the business is a fiduciary responsibility of directors to shareholders. The competitive process provides support for the seller's board of directors (or a fund manager) when presenting the proposed transaction to the board as the best available transaction.	Confidentiality risk: Although the IM and due diligence material are provided to bidders under a confidentiality agreement, it is more difficult to maintain the secrecy of the proposed sale where numerous parties and their advisers and employees are involved. In some cases, a bidder (particularly a trade competitor) may only be interested in finding out information about the target. The seller will not necessarily be able to discover the source of a leak to take action for loss. If not managed effectively, breaches of confidence may damage the business, particularly if the sale is abandoned.
International bidders: The VDR allows a seller to involve offshore bidders in the auction process. A foreign investor will be likely to view the target as an entry-level vehicle into the local market and its valuation may reflect a market entry "premium", thereby increasing the potential sale price.	
Exit: With the high cost of public exit transactions, many sellers find that a tender sale is the best option to liquidate their investment.	

¶13-030 Vendor due diligence

The last five years have seen an increase in the practice of vendors issuing bidders with prepared due diligence reports covering such areas as:

- financial
- legal
- commercial
- environmental
- information technology (IT), and
- human resources.

Typically once bidders have progressed through indicative offer stage into due diligence, they may be provided with an independent third-party expert due diligence report. The scope of such a report will be determined by the targets but will also be consistent with the requirements of bidders. The purposes of a vendor-prepared report are to allow all bidders access to the same diligence reports and to create consistency

in their review and timetable, allowing the vendor more control of the process. Bidders may perform their own "top up" due diligence to supplement what has already been provided.

The "reliance" issues of these reports are negotiated as part of a transaction and should place the purchaser in no worse a position than if it had engaged with the experts in its own right.

¶13-040 Successfully hosting and managing a VDR

This section considers some of the key issues for managing a VDR, including time period, security and protocols.

Time period

From the outset, it is essential that the seller carefully outlines the scope of the due diligence to be undertaken and sets realistic materiality levels before due diligence is commenced. The seller should open the VDR to potential bidders for a pre-determined time period (for example, three weeks) to keep the process moving. A long due diligence process generally translates into higher costs, increased disruption to management and the business and a higher risk of information leaks.

Suggested due diligence folders for the VDR:

1. Corporate
2. Assets (other than real property)
3. Intellectual property (IP)
4. Material contracts
5. Real property
6. Employees
7. Superannuation and pensions
8. Insurance
9. Litigation
10. Related party transactions
11. Restrictive trade practices
12. Risk management.

Security

VDRs are traditionally secured with a username and password for each user together with a policy requiring those details not to be shared with others. Additional security options are available to sellers limiting each bidder's access to an identified computer.

The seller may restrict each bidder's ability to print documents from the VDR. As reviewing documents on screen can be taxing, it may be fairer to allow bidders to print non-sensitive documents and to restrict other documents to "read onscreen only". The seller may also withhold commercially sensitive documents and release

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them in the later stages of the deal to serious bidders whose intentions are less ambiguous (the "black box" method). However, if the seller chooses to use a black box, the seller must correctly represent to bidders the terms and timeframes for release of the information it contains.

In 2006, the tender sale of the "Cleanaway" business of Brambles Industries Ltd to Kohlberg Kravis Roberts & Co (KKR) aroused the interest of the Australian Securities and Investments Commission (ASIC) after Transpacific announced that it was dissatisfied with the process and was reviewing its options. A "black box" of information was withheld from all bidders in the initial bid stages. Transpacific claimed that it was represented that two or three bidders would get access to the black box before final bids were submitted, that this did not occur before KKR was announced as the successful bidder, and Transpacific was not given a chance to improve its offer. No further investigations were undertaken by ASIC.

VDR protocol

The seller should require each bidder group to execute a VDR protocol (Protocol), setting out the VDR access rights and procedures. The Protocol should:

- cover areas such as the form and nature of questions submitted
- require a bidder to nominate one person to be the sole contact for requisitions, and
- reserve the seller's discretion to vary the Protocol to allow it to make documents and answers available to some but not all bidders, and to enter and conclude negotiations with any bidder without notice to any other.

¶13-050 When can a seller disregard bids?

A dissatisfied bidder may try and argue that obligations of good faith and fairness are implied in the tender process under IM protocol. It is therefore important that the seller ensures all documents are drafted to give the seller maximum flexibility when dealing with bidders, including the ability to:

- make documents, questions, answers and reports available to one bidder and not others
- answer one bidder's questions in priority to others, and
- enter into and conclude negotiations with any bidder without notice to any other bidder, irrespective of whether they are the highest bidder.

It is also important that the seller and its representatives and advisers do not make written or oral representations to the bidders which might imply that the highest priced bid will succeed, such as a statement that the sale's principal objective is to maximise price, or imply verbally that stakeholder interests will result in the bid with the highest return winning.

Sale processes — a word of caution

In recent years the Australian courts have taken a closer look at the M&A sale process. A landmark case was *Norcast S.ár.L v Bradken Limited (No 2)*[1] which involved allegations of bid-rigging and misleading or deceptive conduct by PE owned Norcast against Bradken and some its senior representatives.[2]

The implications of this case should be kept in mind throughout the sale process. Specifically:

- "club bidding" or "consortium bidding" by private equity firms anywhere in the world is not beyond the scope of Australia's cartel laws and extra care must be taken to ensure that such arrangements are not caught, and
- care should be taken to ensure that any fee arrangements (for example, an introduction fee payable where the other party enters into a different transaction) are not in substance arrangements not to bid.

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¶13-060 Break fees

This section considers what a break fee is, the regulation of break fees and drafting break fee provisions.

What is a break fee?

A "break fee" is a fee the seller promises to pay to a bidder if the bidder is unsuccessful. It is also known as an "inducement fee" in the United Kingdom, or as a "termination fee", "work fee" or "abort fee". Break fees are designed to compensate unsuccessful bidders for the due diligence and advisory costs incurred in participating in the bidding process.

Break fees have become a commonplace feature of United States mergers and acquisitions and many United Kingdom PE houses require a break fee arrangement before carrying out due diligence. While the Australian PE market was slower to pick up on this trend, break fees are now an established part of the PE landscape in Australia.

The quantum of the break fee is generally equivalent to the costs incurred by the bidder. In the United States, however, break fees on bids involving unlisted entities can be as high as 3% or 4% of the bid value.

As a general rule, the further bidders are asked to go in the process without exclusivity, the more reasonable it is to request compensation in the form of break fees if the bidder is ultimately unsuccessful. By leveraging exclusivity against risk coverage in this way, bidders gain some protection.

Break fees have been criticised as potentially deterring competitive offers from third parties and for unnecessarily pressuring the sellers to accept a bid without considering competitive offers.

1 [2013] FCA 235.

2 Paul Schoff and Kristel Harlow "Norcast v Bradken — a cautionary tale" (Minter Ellison 2013) <www.minterellison.com/publications/Norcast-v-Bradken-a-cautionary-tail-MA201307/>.