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The Mariner / Austock decision: A vote in favour of Directors taking calculated commercial risks

We discuss the recent decision in Australian Securities and Investments Commission (ASIC) v Mariner Corp, focussing on the Court's interpretation of 631(2)(b) of Corporations Act 2001 (Cth) and how this may impact other potential bidders and/ or target entities when considering a proposed bid and the bidder's funding arrangements.

The decision provides helpful guidance on when a bidder may be considered to be reckless or to have engaged in misleading or deceptive conduct when announcing a proposed takeover bid and follows proceedings brought by ASIC in the Federal Court alleging that Mariner Corporation Limited (Mariner) breached section 631(2)(b) of the *Corporation Ac*t by announcing its intention to make an off-market takeover bid for all of the shares Austock Group Limited (Austock) in June 2012 (the Austock Bid) in circumstances where it did not have binding commitments in place to fund the bid at the time of the announcement.

Background

A summary of the facts relevant to the ASIC proceedings are as follows:

- Mariner is an investment company listed on the ASX whose principal activity was to target and engage in mergers and acquisitions. At the time of announcing its intention to undertake the Austock Bid, Mariner had 3 directors, being Mr Olney-Fraser, Mr Christie and Mr Fletcher. Mr Olney-Fraser was the Chief Executive Officer of Mariner and was previously a mergers and acquisitions lawyer, with over 10 years of commercial and legal experience.
- In early 2012, Arena Investment Management Limited (Arena), an investment company associated with Morgan Stanley Inc., approached Austock with an indicative offer to acquire the property and funds management businesses from Austock (an ASX listed public investment company) at a price between $10 and $12 million, which offer was rejected by Austock.
- In mid-June 2012, a representative of Arena approached Mr Olney-Fraser, introducing himself as a representative of Morgan Stanley and enquiring whether Mariner would be prepared to obtain control of Austock's board of directors and then sell the Austock property and funds management business to Arena.
- Mr Olney Fraser met with representatives of Arena on several occasions to discuss how the arrangements might be progressed and, on 25 June 2012, Mariner announced to the ASX that it intended to make an off-market takeover offer for all of the shares in Austock, subject to (among other things) receiving acceptances in respect of at least 50% of Austock's shares, at an offer price of 10.5 cents per share (the 25 June Announcement), valuing Austock at over $14 million. Notably, Mariner ascribed a 'breakup' value to Austock's assets of approximately $20-25 million and, on the trading day immediately prior to the 25 June Announcement, Austock's market capitalisation was approximately $3.5 million,
- On 9 July 2012, Austock announced to the ASX that it had entered into an agreement with Folkestone Limited (Folkestone) for the sale of Austock's property and funds management business to Folkestone (Folkestone Agreement), which included provisions that Austock pay a break fee to Folkestone in the event that the transaction did not proceed in certain circumstances.
- On 12 July 2012, Mariner made an application to the Australian Takeovers Panel (Panel) seeking a declaration of unacceptable circumstances on the basis that the Folkestone Agreement was intended to defeat the Austock Bid and that the break fees were uncommercial. That application was dismissed by the Panel who, instead, made a declaration that the proposed Austock Bid gave rise to unacceptable circumstances on the basis that Mariner "did not have a reasonable basis to expect that it would have the funding in place for all acceptances when its proposed

bid became unconditional".
- On 24 July 2012, Mariner announced that it would withdraw the Austock Bid on the basis that a defeating condition (that Austock not make any material acquisitions) had been triggered as a result of the entry into the Folkstone Agreement.

ASIC Proceedings

In 2014 (some two years after the Panel proceedings and the withdrawal of the Austock Bid) ASIC commenced proceedings against Mariner and its directors alleging that:

- Mariner had contravened section 631(2)(b) of the Act by publicly proposing the Austock Bid in circumstances where it was:

"reckless as to whether they will be able to perform their obligations relating to the takeover bid if a substantial proportion of the offers under the bid are accepted"

- Mariner had contravened section 1041H of the Act by engaging in conduct that was misleading or deceptive, or likely to mislead or deceive, on the basis that Mariner was not permitted to make a takeover bid for Austock where it did not have secured funding and that it misled the market as to its ability to fund the Austock Bid; and
- Each of Mariner's Directors had breached their duty to act with due care and diligence in contravention of section 180(1) of the Act by authorising Mariner to announce the Austock Bid in contravention of sections 631(2)(b) and 1041H of the Act.

In essence, ASIC's allegations for contraventions of sections 1041H and 180(1) of the Act relied on the asserted breach of section 631(2)(b) of the Act, which ASIC claimed was an objective test which required that ASIC only prove that Mariner:

- ought to have been aware of the risk that it would not be able to perform its obligations relating to the Austock Bid if a substantial proportion of the offers under the bid were accepted; and
- proceeded with the proposal regardless of that risk.

ASIC also submitted that, in the alternative, if a subjective test applied, that test only required an assessment of whether there was "any basis for a reasonable belief that Mariner would be able to fund a substantial proportion of offers if accepted".

Court's assessment of section 631(2)(b)

Although the Court dismissed ASIC's submission that an objective test should apply (as-well as ASIC's formulation of the appropriate subjective test), the Court's decision can be said to have been ultimately based on the particular circumstances surrounding the Austock Bid.

Notwithstanding this, his Honour, Justice Beach, made a number of observations that may provide helpful guidance to other potential bidders when considering whether they may be considered "reckless as to whether they will be able to perform their obligations …. if a substantial proportion of the offers…are accepted." when announcing an intended takeover bid, including:

- What does a "substantial proportion" of the offers mean?

His Honour considered that it was the number of shares that a bidder may be required to acquire that was relevant. Further, while not providing a bright line test, his Honour also found that a "substantial proportion" should not mean less than 50% of the shares that are anticipated to be the subject of the offers dispatched with the bidder's statement. This is helpful when one considers that the other provisions of Chapter 6 regarding 'substantial' shareholdings contemplate shareholders that are significantly below 50%.

- When is the relevant time for assessing a bidder's ability to meet its obligations?

Mariner did not have the financial resources necessary to fulfil all of its obligations at the time of the 25 June Announcement. However, ASIC's case was also premised on the fact that Mariner did not have any commitments or assurances from any third party that they would finance or arrange the finance for the Austock Bid.

In this context, his Honour confirmed that when assessing Mariner's ability to fulfil its obligations, Mariner's Directors were required to consider Mariner's expected ability to fund the bid at the time after the relevant offers had been dispatched to shareholders and the bid had become unconditional (i.e. approximately four months after the date of the 25 June Announcement). In this context, in referring to the earlier Panel decision, his Honour expressly noted that, at the time of the 25 June Announcement, there was no obligation for Mariner to have "arrange[d] finance" or have "detailed or

binding commitments to fund its proposed bid" in place, nor was it required to have a "reasonable basis for believing that it could pay for more than a few acceptances".

- What is the test for "reckless" when used in section 631(2)?

The Court undertook extensive consideration of the correct interpretation of the term 'reckless' when used in section 631(2) of the Act and whether a subjective or objective test should be applied and, in each case, what the content of that test should be.

After considering the surrounding circumstances, including the text, intention and the consequences of a breach of section 631(2) of the Act, his Honour determined that the Criminal Code test for "reckless" should be applied (albeit only proved to a civil standard), being as follows:

(1) *A person is reckless with respect to a circumstance if:*

(a) he or she is aware of a substantial risk that the circumstance exists or will exist; and

(b) having regard to the circumstances known to him or her, it is unjustifiable to take the risk.

(2) A person is reckless with respect to a result if:

(a) he or she is aware of a substantial risk that the result will occur; and

(b) having regard to the circumstances known to him or her, it is unjustifiable to take the risk.

(3) The question whether taking a risk is unjustifiable is one of fact.

(4) If recklessness is a fault element for a physical element of an offence, proof of intention, knowledge or recklessness will satisfy that fault element.

His Honour also noted that if, instead, a 'common law' subjective test applied (rather than the Criminal Code test) then, in a criminal or quasi-criminal context, this would require that a particular result be subjectively understood by the defendants and, being aware of that risk, there was a conscious disregard or indifference to that risk.

Court's finding: Mariner did not contravene s631(2)

Ultimately, the Court found that Mariner was not reckless as to whether it would be able to fund the Austock Bid when it made the 25 June Announcement. In reaching that decision, his Honour considered the Directors' expectation of there being a low level of acceptances to be a significant factor when they assessed the level of risk involved in announcing the Austock Bid and, therefore, whether the Directors were reckless as to whether Mariner would be able to fulfil its obligations.

While the Court considered that the Directors did not consider there to be a substantial risk that Mariner would not be able to fulfil its obligations, it also found that the Directors could not be considered to have disregarded or to have been indifferent to that risk (if a substantial risk did in fact exist) in any event.

In reaching its decision, the Court was influenced by a number of the specific factors faced by Mariner at the time of the 25 June Announcement, including:

- The possible external sources of funding available to Mariner given the potential arbitrage opportunity arising from the variance between the proposed announced offer price and the value that Mariner considered could be realised from Austock's assets, which opportunity the Court's considered to be neither marginal nor merely speculative given Arena's interest in Austock's property and funds management business;
- The sophistication of Austock's Directors and the evidence provided that they had previously obtained (in the context of a prior takeover offer) legal advice as to the operation and requirements of section 631(2)(b), which had been specifically considered in the context of the Austock Bid, and that (after considering that advice), the Directors were satisfied that the 25 June Announcement would be compliant; and
- The fact that the Austock Bid was subject to (among other things) receiving acceptances from more than 50% of shareholders and the perceived likelihood that this condition would not be satisfied in circumstances where:
- Approximately 35% of the shares in Austock were held by Austock's directors and their associates and that it was reasonably predictable that, when announcing the offer, the directors of Austock would have recommended that the offer be rejected; and
- Prior to the 25 June Announcement, Mariner had approached a number of other Austock shareholders, including one shareholder who held approximately 8% of the shares in Austock, before announcing its offer and who were not

interesting in selling their shares at the same price.

Misleading or deceptive conduct – funding representation

In addition to the claim for a contravention of section 631(2) of the Act, ASIC also alleged that Mariner had also engaged in misleading or deceptive conduct by making the 25 June Announcement, on the basis that the announcement represented that Mariner *"…had reasonable grounds to believe that it would be able to pay a consideration of 10.5 cents per share for all of the fully paid ordinary shares in Austock as and when required to do so as a result of acceptances of the proposed offer..*" (the Funding Representation).

Section 1041H(1) of the Act provides that a person must not engage in conduct in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive.

In support of its submission, ASIC focused on the fact that the 25 June Announcement did not include any reference to the Austock Bid being "subject to finance" and the assertion that the 25 June Announcement would be considered by the market in the context of section 631 of the Act, on the basis that given to the fact that the audience of the 25 June Announcement included a sub-class of:

"persons who [were] well informed about the usual practice in relation to takeover bids who [would] also have a working familiarity with the requirements of Chapter 6 of the Act" and that "a reasonable member of that sub-class would assume from the fact that Mariner announced a proposed bid that Mariner had reasonable grounds to believe that it would have the capacity to carry that bid through to completion"

While the Court was critical that this claim was somewhat artificial and appeared to be designed to provide a catchall if ASIC was not successful in its claim for breach of s 631(2)(b), it ultimately found that the 25 June Announcement did not convey a representation that

"reasonable or ordinary members of the intended audience would read and understand as a representation that Mariner had reasonable grounds to believe that it would be able to pay a consideration of 10.5 cents per share for all of the shares in Austock. "

Practical lessons for bidders and target entities

Beyond clarifying the technical operation of section 631(2) of the Act, the decision also provides helpful practical guidance for potential bidders when considering their obligations under these funding provisions including:

- the benefit that can be gained through having a clearly documented process that records the bidder's strategy when announcing a proposed bid and supports the bidder's assessment of its obligations and intended means of satisfying those obligations, including any pre-bid 'soundings' that have been made of potential sellers of shares;
- how any defeating conditions and the length of period that the offer will be open for may influence the bidder's assessment of when it will need to have secured funding by; and
- the legitimacy of a bidder making calculated and reasonable assessments of the level of take-up that it may receive in respect of an offer when considering its potential obligations under the bid.

It is noted that some have focussed on the comments made by his Honour in relation to the Panel's assessment of the requirements of section 631(2) of the Act, including that, contrary to the Panel's assessment:

"at the time of the announcement, Mariner was not obliged to have "arrange[d] finance" ([61]). Further, Mariner was not obliged at that time to have in place "detailed or binding commitments to fund its proposed bid" ([63]). And nor did the language of s 631(2)(b) strictly require the "reasonable basis for believing…".

However, in this context it is important to note that the Panel's decision was primarily focussed on whether the Austock Bid had given rise to 'unacceptable circumstances' and not solely whether there had been a breach of section 631(2) of the Act. Therefore, it is important not to forget the Panel's broad scope in declaring that 'unacceptable circumstances' exist. In this context, it is noted the Panel has not indicated whether it intends to update its Guidance Note 14 nor has ASIC in respect of its Regulatory Guide 9, dealing with their own respective interpretations of section 631(2) of the Act in light of the Court's decision.

Accordingly, until ASIC and/ or the Panel provides additional updated guidance, potential bidders are cautioned against treating the decision as unduly limiting the circumstances in which ASIC and/ or the Panel may assert that a bidder's funding arrangements have given rise to unacceptable circumstances. This is particularly important when one considers that Mariner was the subject of an adverse costs order, in part, because the Panel considered that the bid could not have been made because "*no finance had been arranged…*".