COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Corporate Law Economic Reform Program Bill 1998

MONDAY, 22 MARCH 1999

CANBERRA

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JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Monday, 22 March 1999

Members: Senator Chapman *(Chair)*, Senators Conroy, Cooney, Gibson and Murray and Ms Julie Bishop, Mr Cameron, Mr Rudd, Mr Sercombe and Dr Southcott

Senators and members in attendance: Senators Chapman, Conroy, Gibson and Murray and Ms Julie Bishop, Mr Cameron, Mr Rudd and Mr Sercombe

Terms of reference for the inquiry:

Corporate Law Economic Reform Program Bill 1998

WITNESSES

Committee met at 8.02 p.m.

LEE, Mr Peter, Deputy Director-General, UK Panel on Takeovers and Mergers, London

CHAIR—I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Securities. The purpose of this hearing is to take evidence on the Corporate Law Economic Reform Program Bill 1998. I would like to welcome Mr Peter Lee, Deputy Director-General of the UK Panel on Takeovers and Mergers, who is joining us tonight by video link from London. The committee prefers to conduct its hearings in public. However, if there are any matters you wish to discuss with the committee in camera, we will consider such a request.

This hearing will be held while the parliament is sitting, so some committee members may have to leave the hearing from time to time to attend divisions in either chamber. I hope that this will not unduly disrupt proceedings.

Mr Lee, thank you for making yourself available to the committee tonight. We certainly appreciate the effort you have made. I understand that you have a brief opening statement that you would like to make to the committee and at the conclusion of that we will have some questions for you from the committee.

Mr Lee—Thank you. I hope it will be helpful to you if I describe the operation of the UK Takeover Panel and say a little about the mandatory bid rule in the UK. The UK Takeover Panel is a non-government, non-statutory body that regulates the conduct of bids. It is quite independent from the Financial Services Authority and the Department of Trade and Industry. Its main purpose is to ensure that the target company shareholders are fairly and equitably treated. We are not concerned with the merits of a bid.

The panel's membership is wide. It includes all the associations representing the main investor bodies, for example unit trusts, pension funds, investment trusts et cetera; the bodies whose members practise in the field, for example the London Investment Banking Association, the stock exchange and the Institute of Chartered Accountants; and the companies themselves represented by the Confederation of British Industry. Most of those involved in bids directly or indirectly owe allegiance to the system. The panel administers the takeover code, which it can amend or alter at great speed. The system is flexible and speedy and the panel has regulated over 6,000 bids in its 31-year history. Its rulings and decisions have virtually never been disregarded, despite its having no statutory powers. The sanction of public censure and the consequences that may flow from it are powerful.

The day-to-day work of the panel is carried out by the executive, which is a very small group numbering about 30. Half of those are support staff and the other half have executive responsibilities. Of the latter half, three are permanent and 12, including the director-general, are on secondment from city firms for periods of normally two years. The secondees are of different disciplines and from different backgrounds—merchant banking, city solicitors, accountants and stockbrokers. The mix of permanent staff and secondees is, I think, one of the great strengths of the panel. The permanent members provide the essential continuity, and yet all the time others are coming in with up-to-date practical experience of current

practice and thinking, and stimulating new ideas. The executive gives rulings and guidance on the interpretations of this code.

One of the cornerstones of the system is advance consultation. We are very often asked about an offer before it takes place, perhaps on a 'no names' basis, to make sure it gives rise to no problems. Prior consultation before action during a bid is very common, particularly in a contested bid. We welcome this, as it is much easier to rectify something before the event rather than after. We would always exhort consultation at an early stage. Our door and our telephone lines are always open. Sometimes we are contacted at home, often late in the evening. Recently, a colleague was telephoned at 2.30 in the morning for a decision in respect of a bid to be announced at 7.30 that day.

If any party disagrees with an executive ruling, he may appeal to the full panel, which will hear the arguments from each side and decide whether or not to uphold the decision. The full panel is made up of a chairman, a leading lawyer—and I think it is very important that the chairman should be a lawyer; two deputy chairmen; three independent members, all appointed by the Governor of the Bank of England; and the chairmen of each of the 12 member bodies, organisations whose members are involved in the takeover field.

The full panel meets on average three or four times a year to hear appeals from the executive and, in addition, has a routine meeting four times a year. As time is usually critical, we try to assemble a full panel within about 48 hours of notification of an appeal. The procedure before the full panel is fairly informal and legal representation in the strict sense is not allowed. Decisions are promulgated very quickly and usually a public statement is issued.

If the panel decides to take disciplinary action, the offender has a right of appeal to the panel's appeal committee which consists of a permanent chairman, who is a former senior judge, and two others drawn from the member bodies. The appeal committee meets extremely rarely—less than once a year on average. There may also be other circumstances in which a right of appeal lies from the full panel to the appeal committee.

The main objectives of the code are: firstly, equality of treatment for all shareholders of the same class—a bidder cannot pay one shareholder 100p and all others 80p per share; secondly, equality of information; thirdly, fairness and clarity of information concerning the offer; fourthly, sufficient time and information for shareholders to reach a properly informed decision; fifthly, limitation, unless shareholders' approval is obtained, on action by the offeree company board which might frustrate an offer, for example the issuing of new shares or making significant acquisitions or disposals of assets; and, finally, the maintaining of an orderly and informed marketplace, for example by prompt disclosure of dealings by all relevant parties.

The takeover code is based on these and other general principles which are developed into detailed rules and guidance notes. It is a fundamental feature of the code that it is the spirit of the general principles and rules which must be observed. The code applies, therefore, even when completely new situations or problems arise which are not covered by the precise wording of the rules. It is this flexible approach that has been one of the great strengths of the system: the ability to grant a dispensation from the rules where it seemed

equitable and, at the other end of the spectrum, to prevent a transaction which—although not transgressing the letter of the code—breached the underlying thrust and purpose of a particular provision.

One of the cornerstones of the code is the rule that requires any person or group of people acting in concert who acquire 30 per cent or more of the voting rights of a company to make an offer for all the other shares of that company at the highest price they have paid in the previous 12 months. Let me try to explain the philosophy underlying this rule. If control of a company passes into one hand, it is thought right that all shareholders should have the chance to sell their shares at the highest price paid by the new controller.

There are two grounds for thinking this. First, the company is now controlled by a new person where before it was controlled by another or not controlled at all. Shareholders should therefore be given the chance to sell out of the company as they may have a low opinion of the new controller's business ability or methods, or they might not wish to remain in a company which had, say, manufactured cars and was now to produce armaments.

Secondly, the passing of control usually involves the payment of a premium over the market price and hence the receipt of a premium by one or more of the vendors. It is thought right that all shareholders, and not just the old controller, should share the premium and hence the imposition of the obligation on the buyer to offer to all shareholders the highest price he paid for his control shares.

This provision has been in the code since the panel began 31 years ago, although the figure of 30 per cent was introduced into the code in 1974. This requirement has become a totally accepted element in UK commercial and business life. There is no complaint about it. I guess that of the bids made each year, some 15 per cent or 20 per cent are probably mandatory bids.

Thank you very much; that completes my opening. I would be delighted to answer any questions that I can.

CHAIR—Thank you very much for that opening and the detailed exposition you have given on the United Kingdom system, Mr Lee. Have you had an opportunity to examine the changes proposed to be introduced in Australia and to draw any comparisons with the current situation in the United Kingdom?

Mr Lee—Yes, I have. I received an awful lot of papers and I managed to read a limited number of them. Would you like me to make one or two comments?

CHAIR—I think it would be helpful if you were able to draw some comparisons as to how you see the two comparing: where you see differences between what is proposed for Australia and the UK system as it operates now; and any shortcomings—from our perspective—you might see in the differences.

Mr Lee—I would make one general point about your moving towards a panel system—which I obviously support enormously, because I think it has worked very well in the UK. I

must say that, in my experience, it has also worked very well in a lot of other countries. I think whether it is a statutory panel system or not is beside the point.

What I feel echoes, to some extent, what Kim Santow said to you some time ago: if you are going to have a panel system, it is incredibly important that it is given as much power as possible to be the ultimate referee in dealing with takeover bids as they move along. They are obviously an extremely immediate sort of activity where, as I know, you have to make decisions literally hour by hour in order to take account of market activity and such things. Therefore, I would stress the point that I think it should have all conceivable powers to do this job properly and be able to make decisions upon which people can act.

Drawing again from experience around the world, I think it is very important that there should be some sort of speedy appeal system within the panel process. As I described, we have three levels of appeal system. The executive does 99 per cent of the work and makes 99.9 per cent of the decisions. The next body is the full panel, to which an appeal may go. Finally, in certain circumstances we have the top body, which is the appeal committee. Therefore, I think if you can have an appeal system within the panel process, that avoids people needing to go elsewhere.

As to the staff of any panel, the mix that we have, which, in a sense, grew rather like Topsy—by chance—of a few permanent people and then people on secondment from the industry, is an enormously satisfactory way of dealing with it. If that is possible, again, I would advocate that. I will stop there, because that was really the first area that I wanted to comment on—the panel itself. Perhaps if anybody has questions on that—

CHAIR—I note that you commented that, under the UK system, the price required to be offered by the bidder to the other shareholders as part of the mandatory bid is the highest price they paid during the previous 12 months. The proposals in Australia are for the highest price paid during the previous four months. Do you believe that four months is adequate? Why did the UK choose 12 months?

Mr Lee—Personally, I would go for a longer period. As with all time periods, I do not think there is a period which is right and a period which is wrong. I think some other jurisdictions go for six months. My personal view is to go for a longer period than four months. My reasoning would be that a potential controller might buy a very big stake in, say, January at $5 per share and it would be uncomfortable if in the month of July he could make a bid at $2 a share. So I think I would go for a longer period.

Senator GIBSON—Obviously the success of the panel over such a long period of time has depended on the industry's respect for the panel itself. What is the administration cost of running the takeover panel and how do you get the top advisers from the industry to give up time. That is, how are they recompensed for their two-year secondment to the panel?

Mr Lee—The panel at the moment costs about £5 million a year. The staff is about 30 in number, and we would always pay our staff whatever they would have received back at their own office. Whether they are lawyers, merchant bankers or accountants, they would not be out of pocket in any sense. Nor, indeed, would their employer. We have felt that this is an incredibly important point because, as I know from talking to other commissions around

the world, it has often been a problem to pay people at a level above, say, the normal civil servant rate in that particular country. But that is how we achieve it.

Let me just tell you the sources of our income. We have two sources of income. One is a fee charged on all offer documents posted, and that is based on the total consideration for the offer. Secondly, we have a charge of 10p per transaction on the stock exchange where that transaction is in respect of £10,000 or more.

As to the members of the full panel, the chairman and the deputy chairmen, are paid something not very considerable. All the other members are paid nothing because they are, in effect, representatives of, for example, the accountants—the President of the Institute of Accountants or the Chairman of the stock exchange, those kinds of people.

Senator GIBSON—What about the executive? You said that about half of the executive of 30 were on secondment from city firms. Are they paid market rates or do the city firms contribute?

Mr Lee—Yes, they are paid market rates and if you are going to earn X in a firm of lawyers, you would be paid X by the panel. The pay they receive from us is entirely dictated by what they would have received back at their own firm.

Senator GIBSON—One follow-up point about that concerns the turnover of those secondees from the city firms. Is that a very important part of the respect gained by the panel from the industry?

Mr Lee—I think it is incredibly important because it means that an awful lot of people in the city have been to the panel. There is a general commitment to the system. I think also that practitioners obviously have respect for a body which itself is largely made up of practitioners. For example, our chief executive, the director-general, is by tradition and always has been a leading merchant banker. So I think it is a very key element in gaining the respect of those practitioners involved in this field.

Incidentally, I think the benefits to the people who come to us and then return to the industry are enormous. Many of our former secondees are now, for example, leading lawyers or merchant bankers in the takeover world. I think it also greatly benefits the firms who second them to us.

Mr RUDD—On the question of the panel and the secondment of professional staff with experience in the city, in merchant banks and accounting firms et cetera, do you ever run into the problem of conflict of interest and, if so, how do you manage that?

Mr Lee—Generally, we do not. People, when they come to us, are regarded as totally severing links with the firm from which they come and, frankly, it has never been a problem. Within our office we very much work as a corporate group and, therefore, there would never be cases where one person alone is making decisions; it would almost always be two or three or more of us. And so, frankly, that has not ever presented a problem.

I suppose one could conceive of a very unusual case where perhaps a secondee had been very close to a particular client and that client is involved in a hostile bid. I think in that kind of case we would probably make sure that particular secondee played no part in regulating that bid—but that is a very unusual sort of case. Perhaps I should just say of the full panel to which appeals go a few times each year: obviously if anybody on that panel comes from a body which is involved in an appeal, that person would not sit on that panel.

Mr RUDD—On a related question about appeals, you described quite clearly your appellate mechanism which, if I got it right, is at three levels. In the experience of your organisation, which I think you said was of some 31 years duration in the United Kingdom, has there been much incidence of disgruntled parties still taking things to the courts once they have exhausted the internal appellate processes of your structure?

Mr Lee—The answer is 'no'. In 1986, there was a court of appeal decision which said, in effect, that the panel was susceptible to judicial review and since that case there have been only about three or four attempts in 13 years to seek judicial review of a panel decision. All of those cases have been rejected by the courts and, quite honestly, it is therefore almost only an academic possibility at this time.

Mr RUDD—So at present, to the extent that judicial review exists as a formal possibility, that would only extend to questions of the proper execution of due process by the internal mechanisms within your structure. The courts under current practice in the United Kingdom would not have the capacity to re-examine questions of fact and propriety.

Mr Lee—That is absolutely right. It would be, as you say, simply to make sure that our processes had been proper and the precepts of natural justice had been followed. I think it has been made clear by the courts that they would not attempt to intervene in a particular case or take any view on a particular decision.

Senator MURRAY—I have a few questions. Firstly, do any members of your panel come from regional centres such as Edinburgh, Manchester, Cardiff or Bristol, or are they all from London based firms?

Mr Lee—There is a mixture. We do not have a set representation from different parts of the country but certainly we have, for example, a leading lawyer from Scotland, who is both an academic lawyer and a practising lawyer. And it may well be that, simply fortuitously, the chairman of a particular body, like the investment trust body, comes from Edinburgh or from some town outside London. That might also be true of the president of the Institute of Chartered Accountants, which office very much rotates between London and other towns in the UK. So, in a sense, there is a broad coverage but it is not done in an explicit way.

Senator MURRAY—You would appreciate that we are a federation, and my question really goes to whether it is possible to lure people from other centres for a two-year secondment complete with transfer costs of their families and so on?

Mr Lee—Yes. We are talking about the executive which is very much the people who do the day-to-day work and who are committed to it 100 per cent for two years. Some years ago, we did make a particular effort, in fact, to get a number of people on secondment from

Scotland, and we had a number of bankers and accountants over a period of time. That seemed to work very well. They relocated in London for a couple of years and then maybe the body from which they had been seconded, decided that they would thereafter spend time in the London office. So that sort of move worked quite well. I can think of other people who, having spent their two years in London, then went back to, say, Glasgow or Edinburgh, and continued their practice there.

Again, somewhat fortuitously, recently we have had a number of accountants and bankers from Northern Ireland. So getting people from regional centres has tended not to be a difficulty, and it has just happened in a way largely by chance, although we have, at times, tried to spread the net geographically.

Senator MURRAY—Do you have any other countries sending people to you to learn the ropes when they introduce their own takeover panels?

Mr Lee—People have quite often been to us for a short time, such as perhaps a week. As a matter of policy, we have always tended to be unkeen to have people as an integral part of our office, but we have always been extremely happy to have them with us for, say, a week running through all the various issues that arise. Furthermore, different members of the staff—and I have done a certain amount of this—have spent time, perhaps one week or 10 days, at foreign regulators being involved in the process and trying to explain how we would deal with matters.

Senator MURRAY—Do you have any shareholder representatives—as distinct from industry representatives—from shareholders associations, for instance, on the panel?

Mr Lee—No, we do not. The shareholder bodies we have are really industry bodies like investment trusts, pension funds, insurance companies and that kind of thing. Having said that, in principle it seems to me eminently sensible that a panel—whether it is in England or elsewhere in the world—should have a small shareholders representative.

Senator MURRAY—This is my last question, Mr Lee. Has the panel ever had anyone suspected of or actually conducting insider trading as a result of the confidential information they receive?

Mr Lee—No, we have not. Touch wood, it has never been a problem. Clearly, if it were ever suggested or discovered that things had leaked from our office, it would do us irreparable damage. Luckily, that has not happened. We clearly have as high a level of security as we can in terms of locked safes and an incredibly tough policy on clean desks et cetera. We also have the office swept for bugs every few months. We are as vigilant as we can be and, luckily, nothing has ever leaked out.

Senator MURRAY—Thank you, Mr Lee.

Ms JULIE BISHOP—Mr Lee, back on the secondments from industry—and perhaps more specifically—how are the secondees selected or appointed? Do they apply or are they sought out, and who undertakes the process of selection?

Mr Lee—The answer to your last question is that I principally organise the process of selection. How we have done it for many years and continue to do it is by approaching a particular company—whether it is a firm of lawyers, a firm of accountants or a merchant bank—and ask whether they have an appropriate person at an appropriate age and level of seniority whom they would be able to second to us for a two-year period. We would perhaps give them six months notice to see if they could find somebody appropriate.

The reason that we go about it in that way is that we get people who are 100 per cent supported by their employer and come therefore with that mark of ability and success. Then, at the end of that period, that person will go back to that employer. We have found that is a very satisfactory way of doing it. It means we do not have to advertise and have quite difficult processes of selection. We would obviously interview the potential secondee and would normally approve of that person. I have to say that, over the years, we have been sold remarkably fews pups by seconding firms. So I think that works reasonably well.

Ms JULIE BISHOP—In your experience for, say, a city law firm, has the level been of a senior partner or middle ranking partner?

Mr Lee—Perhaps it would be helpful if I very briefly describe the hierarchy of the panel executive. The senior person is the director-general. He is on secondment from a merchant bank. Normally, he would be a senior merchant banker from the corporate finance division. Normally, he would be aged in the mid to late forties and would be a man—or woman—who has been in the industry for maybe 20 to 25 years. Then there are three deputy directors-general, of which I am the senior one. All of us are permanent people, but all of us have been secondees historically. I was a lawyer secondee and my two colleagues were respectively a stockbroker secondee and a secondee from the Bank of England. The next level has three secretaries; they are secondees from city firms of solicitors. Their age and level is that of junior partner, probably in the age bracket of 32 to 35. They have had quite a lot of experience in the corporate finance area. Finally, we have eight assistant secretaries, all of whom are on secondment. They are all aged about 27 to 32 and come from firms of accountants, lawyers, merchant bankers, stockbrokers, sometimes from the DTI—the Department of Trade and Industry—and perhaps from other bodies from time to time. They would generally be, when they come from professional firms, just below the partnership level. They would probably be managers or senior managers who might become partners or directors in the next two or three years. That is the make-up of the executive team.

Mr ROSS CAMERON—Thank you, Mr Lee. In your remarks, you advise that it would be desirable for the panel to be given sufficient powers to be the pre-eminent body in resolution of takeover related issues. You also said that your panel relies for its effectiveness largely on the idea of public censure rather than on compulsory or statutory powers. I was not quite sure what the place of enforcement and compulsory power was and to what extent you relied upon public censure and public opinion.

Mr Lee—We are a non-statutory body—and I readily recognise that we are unusual in the world—so we do not have any legal powers. The fact is that over the years people have been prepared to do what we rule and they have not sought to disobey that or generally to take issue with us and go to the courts. I know this is always a very difficult thing for

somebody not of the UK to understand, but the fact is that the area of sanctions and getting people to do things for us amounts to an incredibly small percentage of our daily concern.

Our daily concern is trying to reach the right answer for a particular issue. I think it works because of the commitment to the system, directly or indirectly, by people involved in the takeover world. Public criticism is regarded as a dreadful thing to happen, as something that will almost certainly adversely affect your profit and loss account and, if you are a private individual, as something that may adversely affect your career. That is really how it has worked in the UK.

Having said that, and trying to put myself in the position of Australia, obviously any panel that you will have will be a statutory panel. Almost everywhere in the world that I am aware of now that sets up a panel for the first time tends to set up a statutory panel. Ireland did this two or three years ago; Switzerland, year or so ago; and South Africa, in the early 1990s. If one has a statutory panel, in a sense the mystique of what makes London work is not so critical, to be honest.

Mr ROSS CAMERON—So you are saying that, if as a community you are blessed with the intrinsic British sense of fair play, it is better to go without a statutory model but, it you lack that ephemeral quality, you can settle for a second-best, compulsory statutory model.

Mr RUDD—We have always needed the rod of the law down here.

Mr Lee—I would not necessarily want you to depict it as a second best. I think that really all I can do is describe how it works in the UK. I have, literally in the last two or three weeks, spent a bit of time with the South African regulation panel in Johannesburg, which is a statutory panel created in 1991. That appears to me to work pretty well. As I understand it, there has not been any resort to the courts in that 8-year period.

Again, it is a short history but the Irish panel has been going for a couple of years or so; that seems to work perfectly well. And, although it has not happened, I spent time in New Zealand some years ago discussing with them the possibility of a statutory panel. Again it seems to me that, had they decided to do it, it would have worked perfectly well. So I do not think it should necessarily be regarded as a second best. I would never wish to try to export something lock, stock and barrel from the UK. I think all I can do is hope that another country would pick up the best bits which are in harmony with their particular system.

Mr ROSS CAMERON—I think it is fair to say that we are all very impressed by your capacity to do it under some kind of industry based consensus rather than by having to rely on the compulsory powers of the state.

CHAIR—Mr Lee, the other part of the takeovers legislation that is being amended is in relation to compulsory acquisitions, where—if I can summarise for you—the main change from the current situation in Australia is that the amendments will remove the current requirement that three-quarters of the registered holders sell their shares during the takeover bid.

Once a takeover offer reaches 90 per cent, it will allow compulsory acquisitions for the remaining 10 per cent to take place at any time rather than just immediately after the takeover bid. It will not allow minority shareholders to in effect stop the acquisition. The only recourse the minority—that is, the 10 per cent remaining shareholders—will have will be to go to court, and the only power that court will have will be to determine whether the compulsory acquisition price being offered is a fair price as determined by an independent expert.

Some of the witnesses we have had before the committee believe that these changes do not give adequate protection to the remaining small shareholders. In particular they are concerned that independent valuers are not necessarily independent, and they believe that the court ought to be able to take into account any events that have taken place during the takeover bid that may or may not have been untoward and which cannot be assessed by the court in this new process. I am just wondering what applies in this situation in the UK and whether you have any views on those changes as they are proposed.

Mr Lee—This is an area which is not covered by the takeover panel or the takeover code; it is very much a matter of company law. Having said that, I am going to express one or two personal views. In the UK, under sections 428-430 of the Companies Act, broadly, a bidder, if he gets to 90 per cent, can compulsorily acquire the outstanding 10 per cent, as long as that whole process is done within a period of about four to six months of the making of the offer. The price that he has to offer to that outstanding minority is the price which he offered in his general offer.

In the UK, I would guess that, at the moment, there are a bit over 200 bids each year, and I would say that, in probably 99 per cent of those cases, the bidder gets to 90 per cent and then compulsorily acquires to achieve 100 per cent. The culture is very much that, when you make a bid, your aim is to get 100 per cent and not have any outstanding minority. Simply drawing from that experience, I do wonder whether it is necessary to go beyond simply giving a bidder the power to sweep up the outstanding 10 per cent—if he gets 90 per cent within a reasonably short time—as opposed to allowing him to perhaps sweep up that minority at some time, way in the future, when, as I understand it, the price is determined by an independent valuer's view. That would be my immediate reaction, but I am obviously not fully au fait with the background debate on this in Australia.

CHAIR—As there are no further questions, Mr Lee, on behalf of the committee, I thank you for appearing before the committee this evening, our time; this morning, your time. As you can see from the range of questions that followed your introductory comments, we have found the evidence you have given and the information you have been able to provide very useful for our deliberations in consideration of the corporations law reform proposals that the committee is examining.

Committee adjourned at 8.53 p.m.