COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

Reference: Mandatory bid rule

WEDNESDAY, 15 MARCH 2000

CANBERRA

CONDITIONS OF DISTRIBUTION

This is an uncorrected proof of evidence taken before the committee. It is made available under the condition that it is recognised as such.

BY AUTHORITY OF THE PARLIAMENT

[PROOF COPY]

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

JOINT COMMITTEE ON CORPORATIONS AND SECURITIES

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, Cooney, Gibson and Murray and Ms Julie Bishop, Mr Cameron, Mr Rudd, Mr Sercombe and Dr Southcott

Terms of reference for the inquiry:

The Corporate Law Economic Reform Program Bill 1998 provided, among other things, for a mandatory bid rule, under which a bidder would be able to exceed the takeover threshold (more than 20 per cent of the total voting rights in a company) before being required to make a general takeover offer. The Committee inquired into and reported on the Bill in May 1999.

During Parliamentary consideration of the Bill in October 1999, the Senate removed the mandatory bid rule. However, the Government indicated at the time that, in view of what it considered to be an important reform, it would ask the Committee to reconsider the matter. The Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, has now asked the Committee to inquire into whether it is appropriate to amend the Corporations Law to include a mandatory bid rule, similar in terms to that proposed in the Bill.

WITNESSES

LEE, Mr Peter, Deputy Director-General, UK Panel on Takeovers and Mergers 1

GREEN, Mr John, New South Wales President, Securities Institute of Australia 11

JARRETT, Mr John, National Policy Manager, Securities Institute of Australia 11

Committee met at 5.41 p.m.

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

CHAIR—I welcome the witnesses who will be appearing before the committee this afternoon. The purpose of the hearing is to take evidence on the committee's inquiry into the mandatory bid rule. This is the first hearing on this particular inquiry, and the committee will be holding a further public hearing in Sydney on 30 March. The committee has received and published 10 written submissions which it will consider along with the evidence it receives during its public hearings in preparing its report. Is it the wish of the committee that that be received as additional material from the Securities Institute. There being no objection, it is so ordered.

The committee prefers to conduct its hearings in public. However, if there are any matters which a witness wishes to discuss with the committee in camera then the committee would consider such a request. The giving of false or misleading evidence may constitute a contempt of the parliament.

I welcome Mr Peter Lee as our first witness this afternoon. Mr Lee is the Deputy Director-General of the United Kingdom Panel on Takeovers and Mergers. Unlike the previous occasion when he spoke to us via video conferencing, this time he is kindly appearing before the committee in person. I apologise for the absence of the House of Representatives committee members for the time being. We expect that when the divisions in the House are finished they will join us. I ask you to make an opening presentation to the committee, and then I am sure there will be questions from committee members.

Mr Lee—One of the cornerstones of the UK takeovers 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 a cash offer to all the other shareholders of that company at the highest price that the buyer has paid in the last 12 months.

Senator MURRAY—What percentage did you say?

Mr Lee—Thirty per cent. That is our trigger. Let me try to explain the philosophy that underlies this rule. If control of a company passes into one hand, it is thought that all shareholders should have the chance to sell the 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 his methods or they might not wish to remain in a company which had, say, manufactured cars and was now going 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 that all shareholders, not just the old controller, should share the premium. Hence the imposition of an obligation on the buyer to offer to all shareholders the highest price that he has paid for his control shares.

This provision has been in our UK takeovers code since the panel began in the late 1960s, although the figure of 30 per cent was introduced into the code in 1974.

CHAIR—Our apologies, but a division has been called in the Senate.

Proceedings suspended from 5.46 p.m. to 6.00 p.m.

CHAIR—Sorry for that interruption, Mr Lee.

Mr Lee—Not at all.

CHAIR—Press on.

Mr Lee—The mandatory bid has been an essential part of the scenery in the UK for over three decades. It is a completely accepted feature of corporate and commercial life, and I am not aware of any objections being voiced against it. I think everybody—companies, shareholders, investors, practitioners—considers that it is a system that works very well.

From looking at our statistics over the last 10 years, it seems that the percentage of bids that are mandatory bids from the outset has ranged from between about five per cent and 15 per cent. So it is a comparatively small percentage of the overall bids. There is no evidence that the price at which the vendor sells the block that gives control to the purchaser is done at other than a very full price. Private auctions are normally conducted, and very often a purchaser is prepared to pay a very full price in order to buy control and perhaps also at the same time obtain the recommendation of the offer by the target company board. So there appear to be no grounds for thinking that the ordinary shareholder is in any way disadvantaged by this process. I am aware of no evidence of side deals being entered into between the vendor and the purchaser.

A mandatory bid must be in cash at the highest price paid by the bidder in the previous 12 months. It must be in cash so that all shareholders may exit from the enlarged group if they wish to do so. Twelve months is obviously an arbitrary period, but we feel that it is an appropriate period to give the best possible protection to the general body of shareholders in the target company.

A mandatory bid should have no conditions attached to it except that it must be conditional on the bidder achieving acceptances to take him to over 50 per cent. Until the offer document is posted, we place certain restrictions on the exercise of control by the offerer. He cannot appoint anybody to the board nor can he exercise the votes attaching to the shares that he has bought. If a party holds between 30 per cent and 50 per cent, any shares that that party buys will automatically trigger a mandatory bid. Once a party holds over 50 per cent, there is no restriction on any further purchasing. They are the essential elements of the mandatory bid that we have in the UK.

CHAIR—As you mentioned, in the United Kingdom system the price to be paid under the mandatory bid is the highest price paid for the previous 12 months. In the bill that was before the parliament here, from which the mandatory bid rule was excised by amendment, the provision was for four months. Do you have any thoughts on which is a more appropriate time?

Mr Lee—Inevitably, all these time periods are arbitrary. I think we have simply had 12 months from the moment we began. I suppose the longer the period, the greater the protection that the general body of shareholders gets. So if, for example, a person did actually pay $1 six months ago and then pays perhaps 50c now, under your proposal the bid would be at 50c whereas under our system it would be at $1. I think we feel that is a bit of extra protection for shareholders. But clearly what period one decides upon is an arbitrary matter.

CHAIR—One of the issues that was raised in opposition to the mandatory bid rule here was the claim that it deprives smaller shareholders of the public auction process which would maximise their possibility of return on the shares under a mandatory bid. Can you give us an outline as to the UK experience on that and whether you believe that is a valid argument or not against the mandatory bid structure.

Mr Lee—From our experience—and that is all it can be—over the last 30 years and more there really does not seem to be any evidence that the best price is not achieved by the people selling the controlling block. There has never been any sort of muttering or comment that I am aware of to that effect. So I think the lack of a public auction does not actually militate against the ordinary shareholder. I think the best price is obtained by the system that we have at the moment. I think very often it is arguable that perhaps the buyer of that block is prepared to pay a very, very full price to get control of the company.

CHAIR—Another issue that was raised was the possibility of a distressed seller with a major block of shares being in the economic circumstances, through other aspects of their business or whatever, such that they were prepared to quit this particular block of shares to relieve their economic distress and therefore would sell at cheaper than the real value of the shares or not gain the premium that would otherwise be obtainable. Do you have any comments on that issue?

Mr Lee—Again, we have no evidence of that from our experience over that 30-year period. Just a general comment: it is very unusual for somebody to get into a distressed position incredibly quickly, so there is usually going to be quite a long time frame. But we have never heard any comment to that effect. So I feel that that probably is not a valid concern.

CHAIR—Can I ask how important the mandatory bid rule is for the UK system and whether there would be any damage to the United Kingdom financial markets if that mandatory bid rule were removed from your system?

Mr Lee—It is an absolutely integral part of the system and has been for 30 years and more. Frankly, if it was got rid of, people would take the view that we were going back to the bad old days of the past. I think it would be a great loss to the market and I guess would be quite prejudicial to the general body of shareholders.

CHAIR—May I ask what the attitude is of the current Blair Labour government in Britain to the mandatory bid rule and what level of support there is?

Mr Lee—Just generally, I think the Labour government have been extremely supportive of the takeover panel since they came to office about three years ago. They do accept that what the

takeover panel does is good and right and that the rules are generally correct. I think the mandatory bid is an integral part of those rules. Therefore I think the government would feel it is the right thing to be doing.

Senator MURRAY—You said five to 15 per cent of all bids are of the mandatory bid kind. Is that by number or by value?

Mr Lee—By number.

Senator MURRAY—You also said that the rule kicks in at 30 per cent.

Mr Lee—Yes.

Senator MURRAY—And has to be exercised to achieve over 50 per cent of the shareholding and the bid is on a cash basis.

Mr Lee—Yes.

Senator MURRAY—What is the significance of the choice of 30 per cent?

Mr Lee—Again, it is arbitrary. As you know, many countries now have the mandatory bid rule and many people have picked different numbers. Some people have picked 35 per cent, some 25 per cent, and some 33 per cent. In a way, each market in the world is different and it is what suits that particular marketplace best. At the beginning when we were starting out in 1968, we started with 40 per cent and we had other rather complicated rules applicable. After about three, four or five years, we came to the view that 30 per cent was about right in the UK. So we went for that number in 1974. Frankly, that is a percentage which has stood the test of time. From time to time, there have been debates in the UK as to whether that number should be changed: should it come down to, say, 25 per cent? But, at the end of the day, the general view of shareholders and companies and so on has been that 30 per cent is about right. That is why we have got it and we have stuck with it.

Senator MURRAY—Some of the percentages which have been in that area are rule of thumb and some are factual. It used to be that 26 per cent shareholding would prevent the passing of a special resolution, for instance, to change the constitution of a company; 25 per cent market share would indicate a dominant presence in the market; around 30 per cent would indicate effective control of a company. The reason I am putting it in that framework is to indicate the belief in my mind that around 30 as opposed to around 20 has always been more of a view as to where effective control takes place where there is a dominant shareholder—that sort of environment, if you like—and that is the time when, if you are going to use this kind of rule, you should encourage the mandatory bid rule to work.

That is really commentary from me. My question to you would be: do you think it is the intention of other countries in Europe, if they are to follow on with the UK approach as per the EU directive, to go to 30 per cent?

Mr Lee—I do not know. I think different countries are going to come up with different numbers. From memory, I think France has gone for 33 per cent and others may go for a different numbers. I do think it is going to depend on the marketplace and the make-up of company shareholder bases in each country. I do not think I would feel that it was right for me to say what is the right number for any particular country to go for. I think it depends on the local circumstances.

Senator MURRAY—Does it matter? If I can put it in perspective, you have indicated that you found 40 was not effective or sensible in your market.

Mr Lee—Yes.

Senator MURRAY—So I assume 30 to 33 or 30 to 27 does not matter much.

Mr Lee—No.

Senator MURRAY—But you have indicated 40 to 30 did matter. Does 30 to 20 matter?

Mr Lee—I think, philosophically, as I said earlier, the key thing is control as opposed to influence. I think we felt that 30 per cent, in a general sense, is where you are likely to get control of a UK company. The acid test, I suppose, is whether somebody with less than 30 per cent is likely to be able to push through a resolution to change the whole boardroom and get themselves and their colleagues onto the board. Anecdotally, I suppose there have been one or two attempts over the years by people with less than 30 per cent to do that and they have tended not to achieve it. So I think it is control that we are focusing on and that is why I think 30 per cent is about right in the UK.

Senator MURRAY—This is the last question I have in this segment: you said, I think, that the cash offer has to be at the highest price in the previous 12 months, didn't you?

Mr Lee—Yes, that is right.

Senator MURRAY—Not the previous four, the previous 12 months. That therefore gives you enough protection for the shareholders so that they are like likely to get the best price over a reasonably long period of market trading.

Mr Lee—Yes.

Senator MURRAY—Four months you would consider too short?

Mr Lee—As I said to the chairman, like all these time periods, it is arbitrary. We have gone for a reasonably long period because we think it gives the greater protection to the general body of shareholders. But I do not think four months is necessarily wrong. It is merely that we have gone for 12 and I think that does give extra protection for the obvious reasons that I mentioned.

Senator MURRAY—The question is about the EU directive. There is much talk, as you know, world wide in political, business and economic circles about globalisation, which also has

an impetus towards harmonisation—being similar in laws and practices. Regardless of how you may argue where a percentage should be, is there a virtue for markets to be as close to each other as possible in type of operation, given that the companies interacting in those markets are often multinational themselves? Is there any virtue, for instance, in Australia being harmonised with the UK market and perhaps with some other countries in the EU which might follow yours very closely?

Mr Lee—It is a difficult question. I am not sure that it is really for me to answer. But I suppose the closer the general world system gets in each country, the better. But, having said that, every country is different. Therefore, it may well be that they have good reasons for doing something different from another country or picking a different percentage. But, on the mandatory bid front generally, it seems to me there is a strong move around the world—and it has already happened to a very great extent—to have a mandatory bid within the particular regulations of a country. But the percentage is often going to be different and I do not think, personally, I would regard that as a matter of great concern if that was the case.

Senator COONEY—This is just a practical question: we now see ourselves as a shareholding country. Are there any guidelines you use that people have to follow to make sure everybody, even smaller shareholders, gets notice of what is going on—which might well cause problems to a board?

Mr Lee—You mean if somebody buys control?

Senator COONEY—I mean that everybody gets a chance to be notified.

Mr Lee—Yes. We have a whole raft of the rules on that. If somebody buys control, there has to be a public announcement literally immediately and all the shareholders must receive a letter to that effect within days. Then the offer document will be posted and it will be posted to all shareholders, so that they are kept fully informed of what is going on and given the opportunity to accept that bid.

Senator COONEY—What happens if somebody is not notified? I was just thinking of a constituent who came in about an issue like this. If this was in operation, he might well miss out. What remedy would he have if he is not notified?

Mr Lee—I think if he really was not sent the offer document, then we would expect the bidder to make sure that he had the opportunity to sell or accept his shares to the bid. It is something that in my experience in practice has not happened, because people are extremely meticulous about making sure that all shareholders are kept fully abreast of what is going on.

Senator COONEY—But, if it did happen, your impression would be even though the transaction generally has gone through you would expect the people buying a company to buy his shares at the price offered originally?

Mr Lee—I think we, the panel, would say: if he had not been sent the appropriate offer document, he should jolly well be given a chance now to sell his shares.

CHAIR—In relation to the European Union, what developments are occurring there? I understand that there has been a recent legislative directive from the commission of the European Community for the enactment of a mandatory bid rule across the European Community, which would require several of the member states to adapt their legislation.

Mr Lee—Yes.

CHAIR—I also understand the directive is based on the current UK system and that would also forbid the board of the target company from taking any defensive measures during the period of the acceptance of the bid once it had received formal notice of the bid, unless there was prior authorisation from a general meeting of shareholders.

Mr Lee—Yes.

CHAIR—Can you tell me what the state of play is with that and how it is intended that directive will proceed.

Mr Lee—The European directive has not been finally agreed yet but I think it is highly likely, highly probable, that it will agreed this year. It is in fairly general terms, but one of those elements is that countries should include in their domestic legislation the mandatory bid rule. I think those countries that have not already got such a rule—and a great number of them already have—would have to introduce that. So that will happen over the next few years, and the antifrustration rule that you mentioned will also be included.

CHAIR—The directive is based on the UK system. But would the specific directive involve any changes to the UK system?

Mr Lee—The only thing that might have to change is that we, the takeover panel, are a non-statutory body at the moment. There is a high probability that we would have to become a statutory body if the directive went through, because the directive's requirements would have to be enacted in UK law which I think would mean that the regulator had to be a statutory body. So that would be a probable consequence. But I do not think our rules would need changing, because they are quite a way ahead of what is being proposed.

CHAIR—Do you believe the board of a company should have prior authorisation from the shareholders to mount a defence against a takeover bid?

Mr Lee—Yes. This has been the philosophy and code of our panel for years. It is the shareholders who should decide on a bid and the management should not do anything which militates against the shareholders being able to make that decision. So any sort of frustrating action should not be allowed—unless it is with the approval of the general meeting, which is democracy and that is fine.

CHAIR—Would that militate against a company being able to defend itself against a bid, do you think?

Mr Lee—If the price being offered is the right price, then one assumes the board will recommend to shareholders to accept that bid. Clearly, if it is too low a price, they will recommend people reject it. Usually, shareholders will follow their board. That recommendation, either way, will simply tend to carry the day. So I think it is right that they should not be able to take specific action to frustrate the bid.

CHAIR—I also understand that, under the EU directive, a bidder must give information about the financing of the bid and announce the bid only after they have assured a sound financing.

Mr Lee—Yes.

CHAIR—Does that mirror what the situation is in the UK?

Mr Lee—Very much so. We would expect nobody to announce a bid unless they had clearly got the money to do so—absolutely.

CHAIR—And they also have to make public that financing arrangement?

Mr Lee—Yes. An independent person would have to announce that the money is there.

Senator CONROY—I just have one question. Is there any sort of pattern that is developed of the types of bidders who use the rule to effect takeover? Are they all large companies? Are they all small companies? Are they medium ones?

Mr Lee—You mean the mandatory bid rules?

Senator CONROY—Yes.

Mr Lee—No, I cannot say there is any pattern that is obvious. It may be smaller companies; it may be bigger. It is just a mix.

Senator MURRAY—I got the impression that, in addition to the Corporations Law provision in your jurisdiction, you also have fairly well developed rules which surround the way a mandatory bid is to be conducted. This is really a request from me: would your body be willing to let this committee have copies of those rules so that we could see what else operates apart from the bare bones of the law?

Mr Lee—Yes, certainly. Just to make it clear, we, the takeover panel, administer the takeover code which is in a sense freestanding and separate from the law. The law really has very little to say about takeover bids in the UK. It is that code that we administer and it is that code that includes all the things that I have been talking about on mandatory bids and other areas. Quite certainly we would be delighted to let you have a copy of that code.

Senator MURRAY—I must say to you through the chair that I think one of the key things the committee would need to look at is a comparison as to where the Australian proposition differs from yours.

Mr Lee—Right.

Senator MURRAY—And perhaps the reasons as to why.

Senator COONEY—You say that there has been not much judicial consideration of this. Has there be any judicial consideration of the rules that you administer?

Mr Lee—The answer is: generally, no; there has not been.

Mr ROSS CAMERON—Your panel is 30 years old?

Mr Lee—Yes. It started in 1968.

Mr ROSS CAMERON—Was there a particular set of circumstances that gave rise to its creation?

Mr Lee—Yes. Briefly, the background is that during the 1960s a number of bids were conducted in a way that was pretty unfair and pretty unacceptable. Broadly, the then Prime Minister, Harold Wilson, said to the Governor of the Bank of England: if you do not sort this out then I will legislate. The Governor of the Bank of England and other senior figures in the city of London set up the takeover panel to regulate bids and to make sure that the mischiefs of the 1960s were eradicated. Examples of the kind of thing that happened were that the board of a target company, as a defensive measure, might issue huge numbers of shares into friendly hands so that the bid could never go through. Maybe the target company made profit forecasts which were frankly pie in the sky and not properly checked out. Also, bidders perhaps offered different prices to different shareholders. There was a whole raft of things that were not satisfactory. That is why the panel came into being and why the code was written at that time.

Mr ROSS CAMERON—Is there any equivalent body in other jurisdictions which has no legislative sanction or backing?

Mr Lee—It is extremely unusual. Switzerland created a body like the panel five or 10 years ago. Now they actually have a statutory panel. I suppose Hong Kong would say that it has a non-statutory system very similar to ours. But, in a sense, I think most jurisdictions which have picked up the concept of the takeover panel have done so in, say, the last decade or so and I think have tended to create statutory bodies rather than non-statutory bodies. An example is South Africa. Another example is Ireland. That no doubt reflects the general view nowadays that things have to be statutory as opposed to non-statutory.

Mr ROSS CAMERON—You talk about the sanction of public censure. What is that? Has the committee ever forcefully employed that sanction to a rogue participant?

Mr Lee—Over the years we publicly criticised a number of people. Undoubtedly it has had a very adverse effect on their careers and maybe their business activities. As the world gets smaller and smaller, if somebody is criticised in London by the takeover panel it has an adverse impact not only on their business aspirations in the UK but all around the world. People immediately become aware of what they have done and what they should not have done.

CHAIR—You indicated that under the UK system it has to be a cash offer. I do not know whether you are aware of it, but part of the tax reform initiatives in relation to capital gains tax currently under way in Australia is to provide complete relief from capital gains tax for scrip-for-scrip takeovers. Is there any difficulty that a scrip-for-scrip takeover would create so it would comply with that capital gains tax provision?

Mr Lee—I suppose the philosophy in the UK is that if somebody gets control of your company then you should be given the chance to get out of the total group—that is, get cash as opposed to being offered shares in the bidding company, which means that you are going to remain a shareholder of that enlarged group. The philosophy that underlies it is that shareholders should be able to get out, completely, for cash. In the UK, we also have capital gains tax rollover provisions which only apply in the case of a scrip offer. But, certainly, there has never been any sort of wish that the mandatory bid should be other than cash. That has been the position for many, many years.

CHAIR—Although a shareholder could in due course exit the company taking over by selling those shares on the market?

Mr Lee—Yes, in theory, as long as they are easily saleable and have not plummeted in value.

CHAIR—Another issue that has been raised here by the Institute of Company Directors is that the ability to make a conditional mandatory bid offer is fundamental to a takeover bid. That was specifically excluded from the Australian legislation, although the legislation gives the Securities and Investment Commission the opportunity to provide relief to make a conditional mandatory bid offer. What is the position regarding conditional mandatory bids in the UK?

Mr Lee—We say the only condition is that the bidder achieves over 50 per cent so that he quite clearly has statutory control of the company. But no other conditions are allowed. The reason for that is that there should be as few hurdles between the shareholder and getting his money as possible. That is what underlies that.

CHAIR—Is there any validity to the argument that a mandatory bidder will pay an extra premium over and above the normal takeover premium to achieve the certainty of a shareholding that takes them well past—in our case—the 20 per cent threshold?

Mr Lee—It is obviously a very difficult question to answer. This is just a personal impression or a sort of a feel, if you like: I suspect a bidder or a buyer is prepared to pay a pretty fulsome price if he knows he is going to get control of that company. So arguably he may pay more than he otherwise would have paid. That would certainly be my impression.

CHAIR—As there are no further questions, thank you very much, Mr Lee, for giving evidence to the committee this evening and for answering our questions. We appreciate it. We look forward to seeing you later in the evening.

[6.34 p.m.]

GREEN, Mr John, New South Wales President, Securities Institute of Australia

JARRETT, Mr John, National Policy Manager, Securities Institute of Australia

CHAIR—Welcome. Do you wish to make opening statements before we proceed to questions?

Mr Green—If I could, thank you.

CHAIR—Please proceed.

Mr Green—First, on behalf of the institute, we are very pleased to have been given the opportunity to appear before the committee. We are also very pleased to have seen the introduction of a number of very significant reforms in the takeover area, some of which took effect this week: the introduction of a strongly beefed-up takeover panel and changes to compulsory acquisition. Late last year, we saw the introduction of capital gains tax rollover relief, and this week we have seen the first significant takeover bid that is seeking to use that—and I do not seek to make any comments on the merit of that bid, but it is interesting that we have already had the first of those.

All of these changes are very important in leading to stronger foundations for a more competitive and efficient Australia by removing many of the factors that have led to lower corporate performance in Australia and lower share prices. Linked to that, we have maintained, over quite a significant period of time, that we believe the evidence is that there has been lower takeover activity and therefore there has been less of a spur to management to perform in Australia. So it has been the wish of the parliament through some of these changes to increase the pressure on Australian corporate management, with the result that there should be greater profitability, hopefully greater share prices and also a freeing up of the takeover market so that shareholders will get better takeover premiums.

We gave evidence previously to the government, during its extensive consultations on the CLERP process that led to the last raft of reforms, that the level of takeover activity in Australia has been significantly lower than in many other jurisdictions. Some of the matters that the parliament has addressed should alleviate that while at the same time maintaining the important principle of equal opportunity for all shareholders.

The mandatory bid is an important part of that foundation, we believe, and we were extremely pleased to have the opportunity to listen to the evidence given by Mr Lee earlier about how, in his opinion, the mandatory bid rule is an integral part of the system in the United Kingdom. We at the Securities Institute—and therefore also our members—have benefited not just from Mr Lee's willingness to appear before this committee now but very significantly from his insight and his interest in this subject. We have had, over a number of years, quite extensive discussions with Mr Lee and some of his colleagues on these issues and have sought to benefit

from the experience in the United Kingdom in leading to the views that the Securities Institute has been putting forward.

Our submissions very simply roll around a number of key points. One is the fact that it would appear that major countries around the world either have adopted the mandatory bid rule or are moving towards the introduction of the mandatory bid rule. The paper, which the chairman tabled earlier, is one that we commissioned that looks at the changes to the legislative environments in many countries in the takeover areas in the last little while. The result is that it appears that what we heard earlier from Mr Lee is quite correct: that it is becoming more and more the norm. So we see it as quite important that Australia is not an odd man out, is not at one extreme and acts in the takeover area in a way that is consistent with the way that many other people in many other countries are thinking.

The second aspect of our submission rolls around the issue of the auction. That, from my experience, is the most argued about piece of the mandatory bid rule. Our submission is that the mandatory bid rule—although we do not expect that it will be used very often, as is the experience in the UK—will add a great degree of extra competitive tension to a process which does not have enough now. One of the reasons why the process does not have as much competitive tension now as it might is that there are many people and companies, both in Australia and especially outside of Australia, who do not wish to play in the public game. They would rather take their money to where they can get greater certainty and greater clarity, with less risk of loss of face than we provide in Australia.

Secondly, there is no argument that I have seen anywhere that says that our process—that is to say, the public auction process—necessarily generates the best price. If you were selling your home, sometimes in the economic cycle you would choose to sell it through a public auction, and you would believe that you would get the best price in that way. At other times you would say, ‘Actually, an auction won’t necessarily get me the best price. I’ve got someone here who has knocked on my door and I can do a deal with them today and I can get a much better price than I might get at an auction—if I’m going to have one—in a few weeks time. I have certainty; I have the price; the market might be very volatile; I do not know what is going to happen; they are looking at the house across the road; they may not be there next week.’ These things happen just the same in the market for corporate control. Companies do not have a passion just for one target; they look at many.

So we are arguing that allowing people to acquire significant or controlling stakes with the obligation then to bid for the rest of the company at the same price is adding people to the process, adding competitive tension and adding new bidders. So in fact we might end up with more takeover bids. So the argument that says that we will have either no change to premiums or lower premiums we do not believe is credible. We believe that there are takeover bids that we do not have, so we will actually be adding wealth to shareholders by this process.

It has been described as a certainty premium; that is, a bidder may be willing to pay an additional amount now for the certainty that they are going to get control and then being able to move very quickly to integrating the company. This, of course, is the area of greatest risk for people making takeovers. It is hard enough in Australia to acquire the company in the first place, but the really big job is to integrate the acquiring company and the target company

thereafter. The longer the delay and the longer the uncertainty, the more difficult it is. It depends on the sector, of course. There are some sectors where it is extremely difficult if it is a very long period of time because you may rely on many people who say, 'I'm not going to stick around.' They may be employees who are quite concerned about what is going on. They do not know where they will be with their jobs. They may be independent agents who sell the company's products out in the field. You really want to be concerned about those people as well. By allowing the mandatory bid rule to be introduced, I think in some cases we may be able to alleviate that pressure.

Another element is that the mandatory bid rule will increase substantially the pressure on target boards. When we advise companies on defence or on bids—that is my day job—we ask them, 'If the mandatory bid rule comes in, what will be its impact on you?' Most advisers will tell you that the impact will be that the target boards will have less power, that what you are doing is enfranchising the shareholders more by giving them the mandatory bid rule because they do not have to listen to the target board. The target board does not have as much control over the process because, as far as concerns the section that did not get through, one shareholder who may have a controlling stake can pass that control to a new party.

That raises the question: if you were a target board, how would you behave from now on if the mandatory bid rule were in place? You would be even more focused on your corporate performance and, in addition, you would be even more focused on your communications with your shareholders. You would want to build trust; you would want to build confidence. You would want to make sure that when the bid comes, if you say to them 'Gosh, we think this offer is inadequate, please don't sell,' that they would listen to you. Alternatively, they might be a shareholder of significant influence that might have a stake that could trip the mandatory bid for you. They might actually come to the board and say, 'We've got this offer, you know more about the company than we do,'—because perhaps we are not the controller, we are a shareholder of some influence—'is this an offer that we should accept?' and then give them some time to do that. But that means the board has to work harder. I think that is the job that the parliament has assumed in more recent times, saying, 'How do we put more pressure on company boards to perform?'

The last point is that the mandatory bid rule, as was proposed in the bill, is a mandatory bid rule that has quite a few more handcuffs attached to it, we believe, than would be ideal. Nevertheless, it was a mandatory bid rule that was resulted in after much consultation, much debate around the country, including with ASIC. So it was a much more conservative model of mandatory bid rule than many would have liked. But it does not compromise minority rights in any way; in fact, we believe it enhances them. Firstly, there is equal opportunity. They get exactly the same price that the controlling shareholder has got—and we believe there is an argument to say that there is a certainty premium. We believe there will be more bids, so there will be a greater market for their shares than there is now. If anything, we would say that, whilst we would be happy if the mandatory bid rule as was proposed was introduced for a trial period, we would be happier if some of the constraints that were tied in with it were lifted. However, we are happy with it as it is.

Mr Jarrett—I will not add anything to those remarks, thank you.

Senator MURRAY—What is a mandatory full bid and its consequence? Also, what is a mandatory partial bid and its consequence?

Mr Green—I am not sure that I understand what a mandatory partial bid is at all.

Senator MURRAY—I have not looked at the whole of your report because it only appeared today. But I have looked at your executive summary, and that refers to mandatory bid requirements—whether there are any requirements for auction and whether partial and/or other non-full bids are permitted. In the summary, it says, 'Australia's takeover regulation is a uniquely restrictive hybrid of these two systems with a relatively low triggering threshold to any per cent and pro rata partial bids not permitted.' Let us start with a mandatory full bid; what is the consequence of that?

Mr Green—Are you referring to this concept of pro rata partial bid?

Senator MURRAY—Let me explain. Not only does this committee have to consider whether mandatory bid rules should be introduced but it also has to consider what kind of rules they should be—whether they should be what the government proposes, whether there should be modification of what the government proposes or whether, in fact, it should be some different system entirely. To date, in today's hearing, we have only really discussed the full bid approach, and I am not at all sure what a pro rata partial bid means.

Mr Green—In Australia until about 1985 or so, we were allowed to have two types of partial bids. One was the proportional partial bid, which we still have today. The other was the pro rata partial bid, which the government of the day, at the pressure of a number of companies at the time, abolished. This in particular was during the BHP saga of that time.

A pro rata partial bid—and it is allowed in many other jurisdictions in the world—was where you would make an offer to all shareholders. You would say, 'I want to acquire 50 per cent of the company, and I will offer to acquire from you 50 per cent of your shares and 50 per cent of the shares of all shareholders.' But if Senator Murray only sells me 30 per cent of his shares instead of 50 per cent—because he will have the right to choose how many of his shares he tenders to me—I then have the opportunity to top up, on a pro rata basis, from all of the other shareholders, the shares that I want to make it up to 50. Perhaps I should put it more simply. If I am seeking 50 per cent, 30 per cent of the shareholders may not respond at all. So, if I get 50 of 70, I am only getting 35. I then will have the opportunity to top up to my 50 from the 70 shareholders who have responded.

It was felt at the time that that created pressure on shareholders which was unreasonable, in particular because the shareholders who were accepting did not know whether they would be selling to me 50 per cent of their shares, 75 per cent of their shares, perhaps even 100 per cent of their shares, depending on how many people did not sell to me. So it was felt at the time that that lack of certainty for the shareholders meant that we should abolish that type of partial bid.

Senator MURRAY—That is what I thought it meant. This report seems to indicate—at least in the bits I have seen—as does other additional knowledge I have, that low thresholds are accompanied by a low kick-in threshold. For the benefit of those who have not read this, that is,

say, effectively five per cent in the USA, 10 or 20 per cent in Canada—depending on whether state or federal law applies—and five per cent in Japan. Low thresholds make partial bids possible because it is unlikely that, if you have to get up to a certain percentage, every single shareholder will want to sell to you and, therefore, it will work. But, if you want to go for a mandatory full bid, it means that, if it kicks in at 30 per cent—which is the British level—in theory you would have to take up 70 per cent if it were offered to you. Is that correct? You could not pick and choose between the shareholders.

Mr Green—Correct.

Senator MURRAY—Then, if you still wish to remain a publicly listed company with quoted shares, you would reissue your shares to whatever percentage you wanted on the market. The reason I am exploring this is that instinctively I am more attracted to the 30 per cent full offer, because it means no shareholder can be discriminated against, than to the low threshold partial offer. Yet ours appears to be a hybrid with a low triggering threshold and yet a full mandatory bid, which I do not think is effective. That is really the issue I am trying to explore with you. I have the feeling—and it is a feeling; Mr Lee made it quite clear that it is an arbitrary matter—that there is not much rationality to a 20 per cent choice. There is a lot of rationality to a five or 10 per cent choice and a partial bid or a 30 per cent up choice and a full mandatory bid, but 20 per cent in the middle satisfies neither objective. You are far more experienced in this sort of thing than I am and I want to hear from you as to whether or not my judgment makes sense.

Mr Green—I think it might be useful to explain why, to my understanding, Australia has a 20 per cent threshold and not a higher one. When the debates took place back in the 1960s about these things, we probably had more bad experiences in Australia than they did in the United Kingdom in terms of markets and takeovers and so on, and we had nickel booms and so on. It was felt that we should choose a number that was clearly below the threshold of control where it was demonstrable that, in the normal case, you would not be at control. There were many arguments about where control sits. Does control sit at 50? Clearly, control should sit at 50. But does effective control sit at 40, 30, 33 or 25? The truth of the matter I think is that effective control depends on the spread of shareholders in a particular company and possibly the size of the company because of the difficulty in getting a significant stake in terms of its cost.

My understanding is that in Australia we said, ‘Let’s shoot short of control so we don’t even have to think about it; what’s a number that is of significant influence and pressure but is not control?’ That was the 20. Then we introduced around that the ability to have partial bids and so on. Then over the years we have taken away some of those pieces of the original legislative framework that was introduced.

Senator MURRAY—But now we have moved on and, with this awful word ‘globalisation’ running around in all our heads, really there are two main models and they affect the three biggest capital markets. One model that affects two of those biggest capital markets, the USA and Japan, is the very low threshold partial mandatory bid model. The other, which is the UK, is the high threshold full mandatory bid model. It just seems to me, even though this may indeed be a question of judgment and arbitrariness, that we fall between two stools. In view of the world having moved on and that we now pay far more attention as countries to harmonising international tax and corporate law and financial practices, it would seem to me to be sensible to

choose one or the other and not to land in between. You are expert in these fields and I would really like almost to say, ‘Look, we’re starting from scratch; now what is your judgment on this?’

Mr Jarrett—I would say, in fact, that Australia probably does not fall between two stools but is actually outside the stools. I will explain what I mean by that. With a 20 per cent threshold, but without the ability on the part of the bidder to make either a partial bid or a mandatory bid, it means that we do not create opportunities for takeovers through either of those mechanisms. So we have a relatively low threshold of 20 per cent when we do not have either of those.

That means that you have—and this is one of the two main bodies of thought—a low threshold. So, in other words, you cannot really build much of a stake before you have to use another mechanism, and that mechanism might be a partial bid that can build your stake. That is why you need to have a low threshold that matches with that, because a partial bid does not necessarily pass on the whole of the bid to every person 100 per cent, like a mandatory bid rule does. So that is a protection for shareholders: to have a low threshold before you can leap into a partial bid. Then, when you have a mandatory bid rule, the threshold would normally be a little higher because you can build a bit of a stake before you go to the mandatory bid—but that means that you can build that stake. However, if you go past that into the effective control situation or potentially effective control situation, you must pass it on to every shareholder. Under a partial bid, you do not necessarily pass it on to every shareholder—

Senator MURRAY—I fully understand that.

Mr Jarrett—and that is the reason why you can force a low threshold. In Australia we actually have a middle ground threshold, but we do not have either of those abilities for a bidder to actually go forward. So we have what is outside of the middle of those two grounds. We are not in between those; we are somewhere off to the side becayse we do not allow the bidder to have either of those potential ways of forcing himself or herself into a stronger position.

Senator MURRAY—But why wouldn’t you? If it works well in the three top capital markets in the world, with our little tiny capital market here why wouldn’t you?

Mr Jarrett—The argument we have is that we should have one of those models. Australia has rejected the partial pro rata bid model in the past.

Senator MURRAY—Which surely means that you have to go the British route.

Mr Jarrett—You have to go down the mandatory bid rule to create that—

Senator MURRAY—Which is the higher percentage.

Mr Jarrett—You might have a higher percentage. But, if you have a higher percentage, you are allowing bidders to get into a stronger position because they can build a higher stake before being forced to make a bid for shareholders. So the low threshold can be beneficial to the shareholders because it forces the mandatory bidder to make the bid at an earlier stage in the

process and, therefore, it is harder for them to actually build a stake. That is why you have that lower threshold in Australia.

Senator MURRAY—Your belief is that that will produce a fuller price at the lower percentage? The only way a shareholder eventually is benefited is by a fuller price or better return over time. It is either a seller or an investor, one of the two.

Mr Jarrett—Being at 20 per cent is not as strong a position for a bidder as being at 30 per cent. If we had a mandatory bid rule at 30 per cent, that would be a stronger position for bidders—and I do not think we necessarily would have a strong objection to that. I do not know what your view is, John.

Mr Green—With the 20 per cent rule, I think the position in Australia at the moment is a conservative one. Our feeling is that, if it were proposed to change the threshold to a higher number, that could be quite controversial here.

Going back a little while, there were some discussions about that during the CLERP debate. I think it was a generally held view—these things have to be tested—that changing the threshold would have been too controversial to contemplate at that time. That does not mean that one should not contemplate it. But, if one did, you would expect to have quite a healthy debate about the merits of increasing the threshold. Certainly, the higher the threshold, the freer the market for corporate control is. Also, you would think there could be greater competition for corporate control because of what John was saying a moment ago: that a bidder who starts from a threshold of 30 per cent is in a much stronger position than a bidder who starts from a threshold of 20 per cent.

Senator MURRAY—If your main objective is to ensure that shareholders are faced with a weaker rather than a stronger bidder, with the inference that that therefore puts them in a stronger position, then you are arguing for the lower threshold, but that needs to be accompanied by the partial bid. Effectively, at the moment, to reach 20 per cent anyway you are in a partial bid regime because, to arrive at below 20 per cent, people are buying parcels of shares effectively on that basis. So that does not make that much sense to me.

Mr Jarrett—You do have a limit of 20 per cent. The choice of a threshold is necessarily arbitrary and it really depends on circumstances, as Mr Lee has said already, and that always could be a matter for debate. In terms of the mandatory bid rule, a substantial size threshold should be there, but I do not necessarily think that the size of the threshold should drive the argument as to whether or not a mandatory bid rule should be in place. With a threshold of 20 per cent or higher, we would argue that there should be something in place that allows the bidder to achieve a substantial stake and go forward with a mandatory bid rule rather than the situation we have at the moment where they must stop and take their chances, so to speak.

Mr Green—Another model that might also deal with Senator Murray's point is that, as the mandatory bid rule has been framed, it allows you to move beyond the threshold through one transaction. So, if you were a 20 and there was somebody who had 10, you could buy the 10 and end up at 30, and then you would have to make a bid to everybody else. If someone were at 30, you could move from 20 to 50 and you could make a bid for everybody else. A case could

easily be made to say that you should not be limited to one transaction but that you could make a number of transactions—it could be one, it could be five, it could be any number. In other words, as long as the parties that you are buying from know that the result of the transaction—and this is a disclosure point—will be a mandatory bid and that they are putting you in that position, there is no damage being done. The greatest argument against it is that you are perhaps putting institutional shareholders into a position of pressure by allowing more than one. I think that argument has limited credibility, but it does have some.

Senator CONROY—I am touched by your concern to empower shareholders. It is something I have spent many years trying to encourage. I ask this purely because I want to ask some follow-up questions and I do not want to put you in a difficult position. You are not working currently for Colonial, Commonwealth or NAB? You may just say yes; I do not care for whom. I just want to ask some questions about the situation. Perhaps I should put these questions to Mr Jarrett rather than to you, Mr Green, if you are not.

Mr Green—I am not.

Senator CONROY—There is market speculation at the moment that NAB may bid $9 for Colonial.

Mr Green—I have seen that speculation.

Senator CONROY—I would be disappointed if I were a Colonial shareholder and it was already over and I thought NAB might have bid $9 if I were only getting $8 from the Commonwealth.

Mr Green—Let us take it out of the realm of perhaps and make it a bit more hypothetical.

Senator CONROY—I thought a $9 bid was hypothetical.

Mr Green—It may be, I do not know. Let us not make it hypothetical. From reading the papers I see that, when Commonwealth approached Colonial, Colonial approached a number of other banks with a view to determining whether or not the Commonwealth bid was the best bid that they would be able to achieve. They ended up deciding to go the route of the Commonwealth Bank.

Senator CONROY—This is the board of Colonial?

Mr Green—Yes. They would do that in this context with the knowledge that the bid would go down a public route—which I think is the essence of your question. So, whilst they must have come to the view that the Commonwealth bid was very acceptable, they were leaving open the opportunity for another party to overbid them. So, yes, there is still the opportunity for shareholder value to be increased if you are a Colonial shareholder if someone comes in over the top.

Senator CONROY—I should say for the record that I am neither a Colonial, Commonwealth nor NAB shareholder, and I am not an AMP shareholder.

Mr Green—It is possible.

Senator CONROY—AMP have had one approach from NAB and their board has rejected it—thankfully, if I were an AMP shareholder. AMP are now claiming that their value is somewhere between $20.30 as opposed to the market price of around $16. It may have gone up or down today, I am not sure. But if I were an AMP shareholder, I would be pretty interested in seeing an auction to try to determine what the true value of my share is. I happen to think AMP are massively undervalued, so I am sympathetic to some of their board crying that they are being treated harshly at the moment. But if I were an AMP shareholder and I were a long-suffering one, as some of them have been since the float, I would want to see a market process to determine what my true value at auction was. If NAB had got away with buying effective control of AMP with their original offer, I would be pretty disappointed.

Mr Green—You would only be disappointed if the price were not a very good one.

Senator CONROY—I want the best price; I do not want a very good one.

Mr Green—But the problem is that you never know what the best price is. How do you know that there were not a number of parties who were interested in acquiring the company but were not prepared to participate in a public auction?

Senator CONROY—They just do not seem to be that reluctant. I have not met anybody who is wandering around going, 'Gee, you know, I've got all these synergies I can gain from buying Colonial and they're going to complement me in all these wonderful ways; they've got these financial services and an operation offshore, but I just don't want to see my name in the paper.' Maybe I just do not mix in the same circles as you do. I just have not met that many shrinking violets.

Mr Green—People in my position do meet people, and those people include shrinking violets. But I have been involved in a number of transactions. The financial services sector is a very interesting one because I think it is particularly appropriate for people who do not wish to make hostile bids. I think there is a view these days that hostile financial services transactions may not be wise, based on various experiences that have occurred in the past.

There have been a number of transactions in which I have been involved where parties have expressed significant interest in acquiring companies where there might even be a bid in place, a hostile bid. Those parties have said, 'We don't want to play in that game but, if you're able to deflect that bid, come and talk to us later. We won't do that. We don't make hostile takeover bids. We won't play in that arena. Even if we get a board recommendation, we don't want to play because the other party may challenge us, may litigate us, may do all sorts of things to damage us, and our reputation is worth more to us than this particular transaction.'

Senator CONROY—We have the takeover panel now and litigation is supposed to be substantially reduced if not non-existent. The litigation question surely is not an issue any more.

Mr Green—The litigation question should not be an issue, I hope that is right—I sincerely hope that is right—but there are many other things that people will do in takeovers. There is the

significant risk that we referred to earlier of loss of face: that people do not like to make bids and lose because their own market rating can be affected significantly. For example, there has been some press comment over a number of years about the fact that St George tried many times to acquire companies and kept on failing. That is not something that would have added significantly to the value of St George shares at that time.

Senator CONROY—That is something for St George shareholders to take up with their board, presumably.

Mr Green—It is. But all I am suggesting is that it is people who run companies and many of them have the view that they will not play in the public game. There are people who do not go to auctions because they do not like that game. They would much rather pay for their house by private treaty because they know exactly what they are doing and they can do it in the privacy of a room. You cannot tell me, I suggest, that the price which is obtained at the time is lower or higher than it might have been if the auction had occurred. The only thing that you can tell me is that the auction process is transparent. But you cannot tell me that the result of the auction process leads to a higher price.

Senator CONROY—And I guess you cannot tell me that the price paid is the best price, and it is not transparent. So I guess that is two strikes as opposed to only one strike.

Mr Green—I suppose I would also say that it depends on who is there at the time.

Senator CONROY—Sure. I guess I have probably grown up with an ANU economics free market degree, the glorious uncertainty of the market. A lot of farmers do not like uncertainty; they like to make sure that they have nice smooth prices being paid to them all the time.

Mr Green—I think it is interesting that in the UK, where the mandatory bid rule has existed, it is not used very often. One might ask why that is the case, and it might be for a wide variety of reasons. But we suspect that one of the reasons relates to the natural predilection of a controlling shareholder or a shareholder who can deliver control—if you already have 20 per cent and they can deliver control to you—and that is that they are not stupid. What they will do is say, 'I'm going to sit back and think whether what you are offering to me today in this room will deliver me the best price—bearing in mind that everyone else will get the same as me—but I am only interested in me. If I think that what you will give me will deliver the best price, I will take it. But if I think that price discovery through a public auction process will give me a better price, then that is what I will do.'

So my suspicion is that what occurs is that people go to the controlling shareholders, or those who can deliver control, and they seek to negotiate. Sometimes they succeed, but more often than not they fail. But what we are doing by suggesting this is adding competitive tension to the process. Through this negotiation process, you come to me and say, 'John, I'd like to buy your controlling interest in XYZ and I'm willing to offer you $5 a share.' I say to you, 'Well, thank you very much but I'm not interested. The share price may be $4, but I think that the benefits to you of this company are significantly more than that. You have enormous synergy value. You need this more than $5 worth. If you want it, my price is much higher, so you'll have to do better than that.' You might be willing to go higher during that process. What you want is the

certainty of getting control. We will have a negotiation. You will say to me, for example, ‘Okay, I’ll offer you $6, but that’s the best price you’re ever going to get.’ What I might say to you is, ‘Well, if you believe that $6 is the best price I’m ever going to get, I’d actually be happy at $6 but I'm not sure that it’s the best price that I’m going to get. So I want to put you to the test and you can go the public auction route.’

But as an alternative, being a sophisticated investor, I might actually make a few phone calls, like Colonial apparently did—although they are not in this situation of a mandatory bid because one is only allowed to own 15 per cent of a bank under the relevant legislation as a threshold level—and I might already have my investment bank working for me. They may give me a view on value and they may go around and talk to all of the likely people who might be willing to make a bid for me. You will conduct a process in that fashion.

Senator CONROY—I would call that a blind auction where the people whom you are approaching do not know about the others. You are actually changing the whole balance then. With the process you are describing, you are changing the whole balance to the advantage of the purchaser, not the receiver.

Mr Green—I am not sure I understand why that is the case.

Senator CONROY—I go to John and say, ‘John, I’ll give you $6.’ John says ‘No, I can do better.’ So I go to you and I say, ‘Look, I’ll give you $5.50.’ And I might say, ‘Yes, I think that’s the best price I can get,’ because I do not know that you have offered six to somebody else. So I accept. Control is passed and everyone else is getting it at $5.50, but you were prepared to pay $6.

Mr Green—Why would you sell to someone who is lower?

Mr Jarrett—That is the opposite of what John is describing. John is describing that the person holding the share parcel—

Mr Green—I am the vendor?

Mr Jarrett—The seller.

Senator CONROY—No, I have become the vendor. I have swapped roles for a moment. I am the vendor. I have approached two people. I have made an offer to you at six, and you have said, ‘No, I think I can do a bit better.’ I have made an offer to you at $5.50, and for your reasons you have decided $5.50 is the best price you think you can get.

Mr Green—I am the buyer or seller?

Senator CONROY—I am the buyer; you are the seller now.

Mr Jarrett—It is the seller who drives the prices. What we are talking about is that the seller goes and tries to find other buyers, not the buyer. The buyer will always try to find sellers if

they are going to give him a significant parcel. It is the seller who has much stronger control in this situation because they can go out and seek other potential buyers.

Senator CONROY—Nobody else is possibly going to gain the control premium. I could wander out and ask everybody else in the world, but I am the person who is trying to buy because I have the control premium. You are now saying that you are the person who will go out and check out all the other—

Mr Jarrett—As the seller, I have a very strategic important stake, so I am not going to just listen to the person who has come and said to me, 'I've really got a good offer for you.' I am going to go and see where those other potential offers might be.

Senator CONROY—You are going to go and look for them, but I am the only one who is going to get the control premium. Other people may not get the control premium. I am on 19 per cent. Control is by getting your 10 per cent. Nobody else may have 19 per cent. Who else will you sell to who will offer you the control premium?

Mr Jarrett—But that is a judgment that the seller will be trying to make. That may well still be the case in a public auction process because a public auction process does not necessarily bring forward other bids. In fact, in the majority of cases, it does not. So it does not drive necessarily any further price. But in this private situation where there is negotiation, I as the seller of a parcel can put more pressure on the person who is trying to buy that strategic parcel.

Senator CONROY—Sure. All I am saying is that you have both gone out and checked. You are saying, 'No, I think I've found a nibble for maybe closer to six or perhaps a little bit more than six.' So you say no. You have gone out and checked, have not really been able to find anyone else. You are at $5.50. I buy your 10 per cent at $5.50. Everyone else is locked into $5.50.

Mr Green—They do not have to accept your offer. You have to make it. You have bought my shares at $5.50—

Senator CONROY—Control has passed. I am in control now.

Mr Green—At this point, you have only got 30 per cent.

Senator CONROY—People run companies with 11 per cent nowadays—less so than over the last 20 years.

Mr Green—I think it would be naive of anyone to suggest that there will never be cases where a public auction process will not generate a higher price than a private process. I think it would be equally naive of people to suggest that there will not be cases of the opposite. What we are suggesting is that we create a situation where all is possible to give more competitive tension. At the moment, you cannot have that discussion with me. It is illegal for us to reach an agreement. So people talk in riddles about, 'Well, do you think if I made a takeover bid at this price you might be inclined to accept it?' and there is all that sort of nonsense going on. We are actually encouraging people to break the law, as things stand at the moment. What we are

saying is: allow people to do commercial transactions, but do it in a fashion that will increase competitive tension—and not keep it constrained as now—by encouraging more people to participate.

Senator CONROY—I am not going to be convinced by your argument that you are actually inducing more people to participate. But I will return to Colonial. You are saying—and I do not know this to be the case, and I guess Colonial will never confirm or deny this—that Colonial went out and had a look when they were approached. They might have gone to NAB, and maybe NAB said, 'No, at this stage we think $8 or $8.01'—whatever they would have put—'is not enough.' So Colonial, under your world, would pass control to Commonwealth at $8.

Mr Green—If there were a controlling shareholder.

Senator CONROY—Yes, if there were a controlling shareholder. I accept that point. But now NAB are saying, 'We're prepared to pay a bit more than we originally told Colonial.' The information was not perfect before. They did not know who was going to take them over. They did not know the market synergies that would be created by Commonwealth and Colonial combining to become a much more serious competitor. It could have been an overseas bank that was trying to buy them that would not have provided the same direct competitive urge. So NAB have an incentive now to pay more to protect their market position and a whole range of things that they would not necessarily have revealed to Colonial. So, if I were a Colonial shareholder and the mandatory bid rule existed and controlling interest had passed right now, I would be pretty frustrated.

Mr Green—And if you were a shareholder in a company—

Senator CONROY—That may never eventuate and it may be that I did end up getting the best price.

Mr Green—And if you were a shareholder in a company whose board had received an offer from another major company and the board told them to get lost so that you never saw an offer in the first place, unlike the Colonial situation—and I will not name any names—you would be unhappy too. But, if the mandatory bid rule existed, that would not be the case because you would be able to deal with the major shareholder, if there were one.

Mr Jarrett—And not the board.

Mr Green—Not the board. So you are empowering the board and not the shareholders.

Mr Jarrett—That is the reality of a Colonial type situation. It is the board that controls that process altogether. There can be no negotiation between the Commonwealth Bank and a significant shareholder or National Australia Bank with a significant shareholder. There can only be, in the circumstances we have, an effective agreement with a board because you cannot have an agreement with a major shareholder under our laws.

Senator CONROY—But the Colonial board cannot deliver to the shareholders.

Mr Jarrett—But it can have an agreement to take to the shareholders.

Senator CONROY—The shareholders are the ones who are going to make the decision.

Mr Green—Yes, I think that is absolutely correct and, ultimately, that is as it should be.

Senator CONROY—Your argument that it is the Colonial board that is empowered and not the shareholders leaves me scratching my head a little. The Colonial board can only make a recommendation to the shareholders. If I were a Colonial shareholder and I heard a rumour that there was $9 out there, I would be hanging on. If that meant that Commonwealth ended up having to up its bid to $8.50 and NAB did not come out, then I still would be pretty happy that Commonwealth were prepared to pay $8.50 rather than $8.

Mr Green—Let us look at the situation though where bidders wish to make a bid on a friendly basis—they do not wish to make a hostile bid—and the board says no. The board says, 'This company is not for sale,' or 'The company is presently at a crisis, at a time of undervalue, and we do not want to consider a bid at this time.' It might be very legitimate for them to do that. They might be correct. But, if the bidder does not wish to make a hostile bid, there will be no bid at that time. The facts of life are that there are many companies who are not willing to make hostile bids. Are you saying that that is not the case?

Senator CONROY—No, I am just shocked that so many shrinking violets exist in the corporate world.

Mr Green—I think there are many people who do not wish to participate in a pugilistic fight in the business world. They have got enough of that. What are you buying when you buy—

Senator CONROY—What happened to empowering shareholders?

Mr Green—What are you buying when you buy a company? You might be buying a brand; that might be the biggest asset of the company that you are buying. What you do not want to do is to do anything that will damage the brand and the people who support that brand. Trust might be one of the very big factors that drives the value in that company. That, as I said, is particularly so in the financial services sector. So it is quite common, in my experience, for companies in that and some other sectors to eschew the prospect of a hostile bid. I am in the business of working for companies who make bids or who defend bids and do mergers and acquisitions. There are many companies that I see to whom I might talk about the prospects of acquiring company A or company B. They will say to me, 'Is it possible to acquire that company on a friendly basis? If so, we are interested; if not, we're not—because there are many jurisdictions in the world where we can buy companies on a friendly basis, and that is what we will do. If we cannot do it, we will not do it. Life is too short.'

Senator CONROY—What happened to empowering the shareholders, the people receiving the bid?

Mr Green—Yes. If you have shareholders that can deliver control, the definition of 'friendly' changes because you are friendly to the shareholders. The power of the board is less than it was before.

Senator CONROY—Then will they not be convinced by the power of the offer?

Mr Green—But how do you do it? How do you convince them? If you launch your bid, the target board says, 'This bid is opportunistic, it's inadequate, it's unsolicited.' It has the hearts and minds of the shareholders for the time being. You are saying, 'I'm not interested in participating in that game; it is not my business. My business is running a bank, an insurance company or a widget company. I am not in the business of running'—

Senator CONROY—Like the GIO board with an awful lot of angry shareholders who want to take a class action against you. So there are risks involved for automatic defensive positions. That will be borne out, I suspect, in court soon. So artificially or inaccurately putting up a defence is not a cost-free position. Equally, having a lot of shares that you have just been issued that can be turned over very quickly at $2 more than you paid for them is powerful incentive too.

Mr Green—It is not always sufficient incentive for a target board.

Senator CONROY—It might be for some executives.

Senator COONEY—Mr Green, you previously were talking about the mandatory bid rule. You said that that brought in efficiency in the terms that the board would want to show to the shareholders that it was a good board, et cetera. I think you said at the start that, in fact, the mandatory bid rule 'enlivened'—if I can use that word—the corporate world. Were you saying that just in terms of the time while the competition for the company was on, or would you put that as a general enlivener of the corporate world?

Mr Green—We believe that it is a general enlivener, that it will change behaviour because it will be a naive board that will say, 'We'll only worry about building trust and communications with our shareholders when the bid occurs,' because by then it is too late.

Senator COONEY—You have given evidence to these committees for many years now. I must confess that, when I first saw you here, you were looking a lot younger. You have said that this is the day job. I am just wondering whether there is any lighter side of John Green?

Mr Green—There probably is.

Senator COONEY—I will not go into that further. This is just a smart point, which I should not make but I will. I was just looking at your educational-professional qualifications. I see that you were with Dawson Waldron for a while—later Blake Dawson Waldron.

Mr Green—Is that what it says?

Senator COONEY—Yes. I thought I would just make a smart little remark to show that I had read that.

Mr Green—Thank you.

CHAIR—As there are no further questions, I thank both Mr Green and Mr Jarrett for appearing before the committee this evening and for their answers to our questions.

Committee adjourned at 7.34 p.m.