CHAPTER 3

TAKEOVERS

Proposed changes to takeovers

3.1 The rationale for the reforms to the takeovers provisions are set out in the Explanatory Memorandum to the Bill:

> The Takeovers reforms contained in the Bill are designed to improve the efficiency of the market for corporate control while encouraging better management and enhancing investor protection. Takeovers, or the prospect of takeovers, provide benefits for shareholders, the corporate sector and the economy since they provide incentives for improved corporate efficiency and enhanced management discipline, leading to greater wealth creation. The reforms are aimed at ensuring that these incentives operate effectively.[1]

3.2 The Bill recasts the existing provisions dealing with takeovers and makes some significant changes.

Mandatory bid rule

3.3 Under this rule bidders will be permitted to exceed the statutory takeover threshold of 20 per cent of the total voting rights in a company provided that they immediately make a full takeover bid (the mandatory bid). The bid price must be the same as or higher than the best price paid by the bidder for shares in the company in the previous four months.[2]

Corporations and Securities Panel

3.4 The provisions relating to the Corporations and Securities Panel (the Panel) are extensively revised by the Bill so that it, rather than the courts or the Administrative Appeals Tribunal (AAT), becomes the primary forum for resolving takeover matters.[3] The courts will continue to determine any damages claims after the bid period and any criminal prosecutions. This will be achieved by:

- opening up access to the Panel to the bidder, the target, the ASIC, or any other person whose interests are affected (rather than being limited to ASIC as at present);[4]

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1 Explanatory Memorandum, para 1.4.

2 Section 611.

3 Section 659B. Since the Panel was established in 1991, only three matters have been brought before it for adjudication.

4 Section 657C.

- ensuring that the courts will not grant injunctions during the bid period except on the application of the ASIC or another public authority of the Commonwealth or a State; and
- having the Panel, rather than the AAT, deal with appeals against ASIC exemption and modification decisions relating to takeovers.

3.5 The Bill permits any interested person, including the bidder, target and ASIC to bring matters before the Panel, which will have the power to make a wide range of orders.[5]

Compulsory acquisition

3.6 The rules relating to compulsory acquisition will be modified to facilitate the acquisition of the outstanding securities in a class by any person who already holds 90% of the class. This is intended to make it easier for majority shareholders to obtain the benefits of 100% per cent ownership. The changes in the Bill will:

- allow all types of securities (not just shares) to be compulsorily acquired;
- removes the requirement currently contained in section 700(2)(c)(ii) that three-quarters of the registered holders have sold their shares during the takeover;
- allow compulsory acquisitions to take place at any time (not just following a takeover bid); and
- allow the minority shareholders to object to the acquisition and provide for the 90% holder to apply to the court for approval of the acquisition.[6]

Listed managed investment schemes

3.7 The Bill extends the takeover provisions to listed managed investment schemes. As a result of this the managers of these schemes will face the same competitive pressure to perform as company directors and members of these schemes will have the same rights to share in a control premium as shareholders.

Streamlining of current provisions

3.8 The rules for off-market and market bids are streamlined. The disclosure requirements are brought together into a single bidder's statement replacing the current Part A and Part C statements and a single target's statement replacing the current Part B and Part D statements. These statements will replace the existing checklist of contents with a general requirement to disclose all information material to a shareholder's decision about acceptance of an offer.

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5 Sections 657D and 657E.

6 Section 664F.

3.9 The Bill rationalises the liability regime for the contents of takeover disclosure documents. The new provisions are generally consistent with the proposed new fundraising rules.

3.10 The *Financial Sector Reform (Consequential Amendments) Act 1998* carried into the ASIC Act the consumer protection provisions contained in the *Trade Practices Act*. It excluded those provisions in the TPA from operating in relation to financial services.[7] This Bill will also remove the overlapping application of the various state Fair Trading Acts.[8]

3.11 In addition, provisions in the Bill will have the effect of removing the immunity of federal government business enterprises from the takeover provisions.

Mandatory Bid Rule

3.12 In its submission the Securities Institute of Australia supported the introduction of a mandatory bid rule. However, it expressed concern that the draft legislation and Explanatory Memorandum were unclear about whether a scrip for scrip bid was permitted. The provisions of the draft Bill have been altered in the Bill currently before the Parliament and now clearly state that while the bid must include a cash offer, the bidder may also offer either securities, or cash and securities, as an alternative.[9]

3.13 The Australian Institute of Company Directors (AICD) also commented on the mandatory bid rule in its submission. The mandatory bid provisions require that a takeover bid made under the mandatory bid rule must be unconditional.[10] However, under its general power to modify the application of the takeover law in particular cases, the Australian Securities and Investments Commission will be able to relieve persons from the obligation to proceed with a mandatory bid, or to allow mandatory bids to be conditional[11]. The Institute considers that the ability to make a conditional mandatory bid may be fundamental to the bid and should be provided for in the legislation.[12]

3.14 The Committee has not been persuaded that the Bill should be amended in this regard. One of the objectives of the mandatory bid rule is to ensure that where control of a company has passed to a bidder all of the remaining shareholders should be given an opportunity to sell their shares on the same terms. The Committee is

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7 Sections 51AAB and 51AF of the *Trade Practices Act 1974*. The definition of financial service is the same as that used in Section 12BA of the ASIC Act and includes providing financial products such as securities and futures contracts.

8 Section 995A.

9 Section 621(2).

10 Section 611, Item 5.

11 Section 655A.

12 Australian Institute of Company Directors, Submission 22, p 2.

concerned that the objectives of the rule could be circumvented by a bidder attaching conditions to a bid which would make it highly unlikely that the bid could proceed. Given that the mandatory bid rule is opening a new avenue for takeover bids in addition to those already existing under the current legislation, the Committee does not consider that the restriction on conditional bids will unreasonably restrict takeover activity.

3.15 The Committee is also mindful that the Government has undertaken to review the operation of the mandatory bid rule two years after its commencement, to ensure that the Government's policy goals with the introduction of the mandatory bid are being achieved.[13] The requirement that bids be unconditional can be reviewed at that time in light of experience with the legislation as proposed.

Withdrawal of market bids

3.16 The AICD considers that the provision of proposed section 652C, which allows a bidder to withdraw a market bid under certain circumstances, should be extended to mandatory bids.[14] The circumstances set out in section 652C largely deal with actions which might be taken by the target company to thwart a bid.

3.17 In considering this matter the Committee has taken into account the objectives of the introduction of the mandatory bid rule; the provisions of section 614, which places some restrictions on the actions of target companies; section 652B which allows a bid to be withdrawn with the consent of the ASIC; and the powers of the Takeovers Panel to declare conduct to be unacceptable. In light of these avenues for redress the Committee does not consider that any amendment to the Bill is currently required. However, this issue could be considered as part of the Government's review.

Escalation Clauses

3.18 The Securities Institute of Australia also expressed concern about the general prohibition on escalation clauses contained in section 622 of the Bill.

> In our view, escalation clauses should be allowed in any takeover situation. They allow a seller, prior to the offer, to reach an agreement that, if a full bid occurs, any price obtained will be increased to match the bid price if that price is higher than the one obtained prior to the bid. This will be of comfort to the seller and encourage the development of stakes by bidders in preparation for a bid. It is illogical to allow escalation clauses only in mandatory bid situations and we recommend that they be allowed for all takeovers.[15]

13 Explanatory Memorandum, para 7.10.

14 Australian Institute of Company Directors, Submission 22, p 4.

15 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 105.

3.19 The Bill merely maintains the current prohibition on these clauses except in the case of an acquisition which triggers a mandatory bid and is, therefore, part of the active takeover process.[16] The Committee has not been persuaded that the Bill should be amended.

Consideration offered during the bid

3.20 In correspondence to the Committee Chairman, the Minister for Financial Services and Regulation, the Hon Joe Hockey MP, outlined some additional takeover issues raised by the Companies and Securities Advisory Committee (CASAC). This followed a recent takeover bid and Federal Court decision which highlighted problems with the provisions of the current law, and the CLERP Bill which contain the equivalents of these provisions.

3.21 Under section 621(4) of the Bill, where a bidder makes a cash-only bid or includes a cash-only alternative:

> (4) If:
>
> (a) a person makes a takeover bid; and
>
> (b) the consideration, or one of the forms of consideration, offered under the bid for the securities in the bid class consists solely of a cash sum for each security;
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> the amount of that cash sum must equal or exceed the maximum consideration that the bidder or an associate provided, or agreed to provide, for a security in the bid class under any purchase or agreement during the 4 months before the date of the bid.

3.22 This provision is consistent with section 641 of the existing Corporations Law. By contrast, where a bidder makes a non-cash-only bid, that is, any bid that does not provide a cash-only alternative, neither the current legislation nor the Bill require that the value of the bid consideration match any price the bidder paid for target company shares in the four months prior to the takeover bid.

The Evans Deakin takeover bid

3.23 In October 1998, Evans Deakin purchased 78 million ANI shares on the stock market for $1.05 each. Subsequently Evans Deakin made a conditional Part A cash and scrip bid, with no cash-only option, for ANI. The bid valued the ANI shares at approximately 90c each.

3.24 Under the current provisions, which are reflected in the Bill, Evans Deakin was not required to offer consideration at least equivalent to the on-market cash price

16 Section 622(2).

it paid for ANI shares immediately prior to the takeover bid because it made a non-cash bid.

3.25 CASAC considered whether section 621(4) of the Bill should be extended to all bids or alternatively should not be proceeded with. CASAC advised that, under section 621(4) of the Bill as it stands, some shareholders could obtain premiums for selling their target company shares in the pre-bid period, compared with the consideration offered to offeree shareholders. This might create an impression of inequitable treatment among shareholders. Institutions might also be placed under pressure to enter into pre-bid share deals on terms that would not be available to offeree shareholders under the bid.

3.26 CASAC recommended that section 621(4) be extended to all bids, including non-cash-only bids, adding:

> The Advisory Committee recommends that CLERP Bill s 621(4) be extended to all bids, including non-cash-only-bids. The Bill should stipulate that the value of any quoted shares offered as part of the consideration should be determined as the average of the market price paid for those shares in the five trading days prior to the announcement of the bid.[17]

3.27 The Committee has considered this issue based on the evidence contained in the CASAC report and agrees with the recommendations contained in that report. However, there is some concern among Committee members that they have not had the opportunity to canvas this issue with a wider range of interested parties. While the Committee, on the basis of the evidence it has considered, would agree with a decision by the Government to act on that recommendation, it would also be prepared conduct a more detailed examination of the issue following the passage of the Bill as currently drafted.

Collateral Benefits

3.28 The Australian Institute of Company Directors has suggested that section 623 of the Bill be amended. Section 623(2) of the Bill, as well as the equivalent current provisions, prohibit an intending bidder, in the four months preceding the bid, from giving target company shareholders any benefit not provided to all shareholders under the takeover bid. Section 623(3) prohibits a person, or an associate, from giving a benefit to a person as an inducement to dispose of securities in a way which leads to a mandatory bid unless that inducement is provided to all shareholders under the bid.

3.29 The Institute considers that the provision creating the prohibition during the 4 months prior to the bid is too broad and creates unnecessary difficulties for companies

17 Companies and Securities Advisory Committee, *Recommendations for reform of ss 621(4) and 623(2) & (3) of the Corporate Law Economic Reform Program Bill 1998*, December 1998, p 4.

trying to move to the 20% control level prior to a bid.[18] This matter was discussed during the Committee's public hearings.

> there is an issue which has plagued practitioners in this area and companies wishing to make takeover offers. That is the area of collateral benefits.
>
> … It has been particularly problematic in the four months up to the bid and there have been a number of cases on this issue. It still has not resolved the issue. There has been recent litigation, both in the Federal Court and the Supreme Court, which has left the issue uncertain as well.
>
> CASAC[19] has analysed that issue and takes the view in its anomalies report on the takeover law that the policy underlying 698(2) and (4), which covers the four-month period prior to the bid, is misconceived because what the takeover provisions are seeking to do is to regulate opportunity of participation while the takeover offer is on foot, not in the four months leading up to the takeover offer. CASAC recommended that those provisions be repealed, and the institute would recommend that as well.[20]

3.30 In its submission to the Committee the Institute said that it believes that the prohibition contained in proposed section 623(2) of the Bill should be repealed and that the prohibition in proposed section 623(3) should be limited to apply only to the bidder or a person who proposes to make a takeover bid or an associate.

3.31 In Correspondence with the Committee the Minister for Financial Services and Regulation, the Hon Joe Hockey MP, has also raised issues relating to this section. Following a recent court case he requested CASAC to examine whether sections 623(2) and (3) of the Bill should be retained. This move follows on from the Federal Court's decision in *Aberfoyle Ltd v Western Metals Ltd* (1998) 28 ACSR 187. The Federal Court's decision raised market concerns about the application of the current provisions in the Law and the equivalent provisions in the Bill. In particular the Court's findings raised concerns that:

- a bidder cannot make unconditional acquisitions of target company shares from institutions prior to a conditional bid;
- pre-bid acquisitions cannot be made through stock market crossings (where the broker acts for both the buyer and the seller); and
- a bidder company cannot fund a bid by placing shares with institutions that hold shares in the target company.

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18 Australian Institute of Company Directors, Submission 22, p 2.

19 This refers to the paper produced by the Legal Committee of the Companies and Securities Advisory Committee, *Anomolies in the Takeover Provisions of the Corporations Law*, March 1994.

20 Mr Ronald Forster, Australian Institute of Company Directors, Committee Hansard, 22 January 1999, p 139-140.

3.32 In the *Aberfoyle* takeover bid, various institutions sold their target company shares to the intending bidder in the four-month pre-bid period under unconditional cash contracts. By contrast, the subsequent takeover bid was a conditional cash offer.

3.33 The Federal Court stated that these institutions may have gained a "very real commercial advantage (perhaps measurable in money) …when compared with a person who enters into a conditional contract [under the subsequent takeover bid] and whose ability to sell his [target company] shares is contingent on a range of events none of which he has any ability to control."

3.34 Before the *Aberfoyle* decision, it was generally regarded that this form of pre-bid cash transaction for target company shares would not constitute a benefit prohibited by the current provisions, given that the bid price could be no less than the highest cash payment in that period.[21]

3.35 The pre-bid sale by some institutions of their target company shares to the bidder was conducted under a crossing arrangement on SEATS, that is a prearrangement between buyers and sellers. The Federal Court ruled that only those transactions that operated on a 'first come first served' anonymous basis would satisfy the ordinary course of trading test, whether they took place on the trading floor, or on SEATS.

3.36 CASAC indicated that the distinction made by the Court between anonymous trading and a crossing may not be practical for the purposes of large lines of stock. CASAC considered that the Court's ruling would restrict a bidder's ability to acquire a pre-bid stake.

3.37 The Court also held that a placement by the bidder to institutional shareholders of the target company contravened section 698 of the Corporations Law as it constituted an inducement for those shareholders to accept the bid.

3.38 Until the *Aberfoyle* decision, many practitioners had taken the view that a placement of bidder's shares with institutional investors holding target company shares would not contravene section 698, as any benefits the institutions received would not be in their capacity as shareholders of the target. The Court's decision casts doubt on the legality of such placements and, as CASAC has noted, restricted the ability of bidders to fund their bids.

3.39 CASAC advised that the Court's decision extended the previously accepted meaning of "benefit" and placed restrictions on the acquisition of target company shares in the four months prior to the bid. According to CASAC, the restrictions

21 See ASIC Information Release 95/31 and section 641 of the Corporations Law.

imposed by the *Aberfoyle* decision are inconsistent with the underlying principle that a person should be free to acquire up to 20 per cent unfettered by takeover regulation. [22]

3.40 CASAC has therefore recommended the removal of sections 623(2) and (3) from the Bill. But, as CASAC advised, this may be seen as undermining the equal opportunity rule by allowing bidders to offer benefits to some target company shareholders that are not offered under the bid. However, these concerns would be allayed if CASAC's recommendation to extend the operation of section 621(4) of the Bill were adopted.

3.41 The Committee has not had an opportunity to take evidence on this issue from other parties. The Government may therefore care to accept CASAC's recommendation, or proceed with the Bill as drafted and refer this matter to the Committee for further consideration.

Bidder's statement formalities

3.42 Section 637(1)(a)(ii) of the Bill requires that where a bid is made other than on a cash only basis, the bidder's statement lodged with the ASIC must be approved by "a unanimous resolution passed by all the directors of the bidder". The Australian Institute of Company Directors have urged that this provision not be included as it is likely to cause significant problems where directors are on the board of both the offerer and target.[23]

3.43 The Committee appreciates that there may be some circumstances where a conflict of interest may arise. However, it notes that this requirement only applies to bids made other than on a cash basis and that the ASIC has the power to modify the law in this respect if necessary.

Target's statement content

3.44 The AICD considers that the standard for disclosure contained in section 638 is too onerous in light of the limited time available to the target to prepare a statement.

> The AICD considers that the expanded test imposed for disclosure in the target's statement should not be determined by having regard to what "professional advisers would reasonably require to make an informed assessment whether or not to accept the offer under the bid". While this test is appropriate in the context of a company issuing securities the AICD submits that it is not appropriate for a target company having to respond to a takeover bid within a 14 day time period.[24]

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22 CASAC's view that, in principle, a bidder should be free to acquire up to 20 per cent unfettered by takeover regulation is consistent with the CLERP Bill policy underlying the mandatory bid rule; that is, to allow bidders to build up a strategic stake before making their bid and to minimise the uncertainty surrounding the takeover bid process.

23 Australian Institute of Company Directors, Submission 22, p 3.

24 Australian Institute of Company Directors, Submission 22, p 3.

3.45 The Explanatory Memorandum to the Bill outlines the reasoning behind the provisions and how they take into account the time constraints faced by a target.

> The general disclosure rule for the target is based upon the general disclosure rule in the proposed fundraising provisions. This type of disclosure rule is considered appropriate as it will require the target to focus on what information is required by holders of the target's securities to make an informed decision.
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> The general disclosure rule will only require information to be included in the target's statement if the target actually knows or ought reasonably to have obtained the information by making enquires (proposed paragraph 638(1)(b)). In addition, given the different circumstances in which takeovers occur, in determining what information it is reasonable for a target to include, regard may be had to the time period in which the target's statement must be prepared (proposed paragraph 638(2)(d)).[25]

3.46 The Committee is satisfied that the provisions contained in the Bill make adequate allowance for the time constraints which will be faced by target companies.

Scope and powers of the Panel

3.47 The scope and powers of the Panel have been criticised in several submissions received by the Committee. In particular Justice Santow, the Securities Institute of Australia and the Australian Institute of Company Directors have all expressed reservations about some aspects of the legislation.

3.48 The Securities Institute supports the proposal to make the Corporations and Securities Panel the main forum for resolving takeover disputes. However, it considers that the Takeovers Panel should have wider powers. It should be empowered to make rules for takeovers, to enforce its own rulings, to declare conduct to be ‘acceptable’, and to initiate its own inquiries. The Institute has also expressed concern about the removal of the courts ability to provide injunctive relief and the ability of the Panel to fill this void.[26]

3.49 While the concerns raised by the Institute are not unreasonable, the Committee is satisfied that the proposed legislation will be effective. For example, the Securities Institute has raised concerns about the ability of the Panel to act quickly. However, section 657E of the Bill gives the Panel, or the President of the Panel, the power to make an interim order, even where no application for a declaration of unacceptable circumstance has been determined, or even received.

3.50 Similarly section 657C provides that the bidder, the target, the ASIC, and any other affected person can apply to the Panel for an order. While the Securities Institute may feel that the Panel should have the express power to intervene when the takeover

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25 Explanatory Memorandum, paras 7.92-93.

26 Securities Institute of Australia, Submission 9.

process is being abused, it appears to the Committee that it is highly unlikely that the Panel would need to intervene if all of the affected parties, and the regulator, were satisfied with events.

3.51 The Australian Institute of Company Directors has expressed dissatisfaction with proposed section 657(G)(2). This section allows only the ASIC to apply to the courts for an order to enforce compliance with an order of the Panel. The AICD considers that any party who can apply to the Panel for an order should be able to apply to the court for enforcement of that order.[27] While the Committee has some sympathy with the AICD's position it notes that one of the objectives of the legislation is to curb the egregiously litigious nature of Australian takeover activity and that section 657 is consistent with that objective.

3.52 The Committee strongly supports the objective of making the Panel, rather than the courts or the Administrative Appeals Tribunal (AAT), the primary forum for resolving takeover matters. The UK Panel on Takeovers and Mergers has been operating successfully for thirty one years and has regulated over 6,000 bids.[28] It provides a good example of how a Panel can quickly and effectively dealt with such matters. Mr Peter Lee, Deputy Director General of the UK Panel, emphasised to the Committee the commitment of the business community in the UK to the Panel. He outlined the importance of being able to recruit the best people available for secondment to the Panel, and pay them appropriately.

> 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.[29]

3.53 Mr Lee indicated that about half of the executive of 30 were on secondment from city firms. When asked whether those executives were paid market rates he said:

> 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 firm.[30]

3.54 He then went on to outline the benefits of this approach:

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27 Australian Institute of Company Directors, Submission 22, pp 4-5.

28 Mr Peter Lee, Deputy Director-General, UK Panel on Takeovers and Mergers, Hansard 22 March 1999, p 175.

29 Mr Peter Lee, Deputy Director-General, UK Panel on Takeovers and Mergers, Hansard 22 March 1999, p 178-179.

30 Mr Peter Lee, Deputy Director-General, UK Panel on Takeovers and Mergers, Hansard 22 March 1999, p 179.

> ….. 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. [31]

3.55 Mr Lee went on to describe how this level of commitment to the UK Panel has also contributed to the acceptance of its rulings and the rarity of any legal challenges.

> 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.

The Committee considers that the Bill will establish an effective system and that the roles of the Panel and the ASIC as set out in the Bill are reasonable at this stage. The Government has stated its intention to review the reforms in relation to the Takeovers Panel after 2 years.[32] The Committee hopes that this review will consider further expanding the role of the Panel.

Compulsory Acquisitions

3.56 Several individual shareholders and the Australian Shareholders' Association have expressed concerns about the compulsory acquisition provisions of the Bill. Mr Elkington, for example, has said that the proposed amendments "reflect the view that

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31 Mr Peter Lee, Deputy Director-General, UK Panel on Takeovers and Mergers, Hansard 22 March 1999, p 179.

32 Explanatory Memorandum, para 2.41.

dissenting shareholders and other minorities are simply a nuisance, to be swept away without any regard to general considerations of fairness".[33] Their concerns range across several provisions in the Bill and the main areas of concern are summarised below.

Extended scope of compulsory acquisition provisions

3.57 Proposed section 664A will introduce into the Corporations Law a new provision allowing a 90% majority shareholder to compulsorily acquire the remaining shares at any time. In the existing legislation a compulsory acquisition can only occur where it follows on from a takeover bid. Witnesses before the Committee said that this confers a significant new power on majority and controlling shareholders, which has the potential to be used as an instrument of oppression either immediately or at some future time. The section is confiscatory in nature and it is therefore important to consider whether it always operates fairly or can be used as a means of oppression.

3.58 The Explanatory Memorandum to the Bill sets out the objectives of this provision.

> Extending the power to compulsorily acquire securities will:
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> - allow better management of company groups;
> - reduce the administrative and reporting requirements of associated companies by:
>   - helping parent companies distribute funds between subsidiaries;
>   - protecting the confidentiality of commercial information and avoiding conflicts of interest in dealings between associated companies; and
> - discourage minority shareholders from demanding a price for their securities that is above a fair value (often referred to as 'greenmailing').[34]

3.59 The Committee received evidence from several small shareholders and from the Australian Shareholders' Association expressing concern that this provision disregarded the rights of minority shareholders. While the Committee is not unsympathetic to their views it is also aware that those minority shareholders are not the only stakeholders who need to be considered. The presence of a small minority interest can impede the efficient running and profitability of a corporation. This then affects the value of the business to the ultimate owners of the majority shareholder and can also have some effect on Australia's overall economic efficiency. The Committee

33 Dr Gordon Elkington, Submission 13, p 4.

34 Explanatory Memorandum, para 7.31.

believes that, provided the minority shareholders receive fair compensation, this extension of the compulsory acquisition provisions is justified.

3.60 However, the Committee is concerned that the absence of any time limits on this extended power may place minority shareholders in a position of ongoing uncertainty about the status of their shareholding in a company. The Committee therefore feels that some time limit should be imposed on this extension of the compulsory acquisition provisions.

Recommendation

3.61 The Committee recommends that section 664A be amended so that a compulsory acquisition can only occur within 6 months of the proclamation of the legislation or within 6 months of the person seeking to make the acquisition becoming a 90% holder.

Limited powers of the court to intervene

3.62 Proposed sections 661E and 664F limit the power of the court to order that securities not be compulsorily acquired to cases where the consideration offered is not regarded as fair. Objections have been raised to these sections on the basis that they disregards other aspects of the fairness of a compulsory acquisition such as the offerers conduct preceding the offer.

3.63 The Committee believes that these provisions should be considered in the context of the whole Bill. Although these sections do not allow the court to consider matters other than fair value the Bill makes extensive provision in other places to deal with any illegal or inappropriate conduct preceding the offer. The Panel, for example, is empowered to declare circumstances relating to a takeover to be unacceptable (section 657A) and to make appropriate orders to protect the rights and interests of any person who has been affected by those circumstances (section 657D). Part 2F.1 of the Bill gives the court extensive power to deal with oppressive conduct against minority shareholders. Part 2F.1A of the Bill introduces a statutory derivative action which will allow shareholders to commence proceedings on behalf of a company where the company is unwilling or unable to do so. The ASIC Act and the Corporations Law now contain extensive provisions aimed at remedying false, misleading and unconscionable conduct. The Committee feels that these provisions provide adequate protection for minority shareholders and that there is no need to duplicate these protections within the compulsory acquisition provisions.

3.64 In its Report on Compulsory Acquisitions and Buy-outs, the Companies and Securities Advisory Committee highlighted the possible consequences of expanding the range of matters which can be considered by the court.

> There should be no “proper purpose” requirement for the exercise of a compulsory acquisition power, nor should the court have any power to set aside a compulsory acquisition on any non-procedural grounds other than

> fair value. Either provision could give rise to protracted litigation and legal uncertainties, …[35]
>
> The Committee also notes that minority shareholders may benefit from being offered fair value for their shares. Those shareholders could be disadvantaged if a small group of dissident shareholders could stop the compulsory acquisition process by arguing grounds other than fair value.[36]

3.65 The Committee is satisfied that the only issue which should be considered by the court is whether terms set out in the compulsory acquisition notice give a fair value for the securities.

Valuing securities

3.66 Proposed section 667C proscribes a new method of valuing company securities for the purpose of compulsory acquisition. Sections 667A and 667B deal with the production of an experts report to support the compulsory acquisition. Witnesses were concerned that the proposed method of valuation does not take into account all of the relevant factors, such as whether the offer is both fair and reasonable, and takes into account the actions of the majority shareholder prior to the offer. Concerns have also been expressed that an expert report prepared by an expert appointed by the majority shareholder may not be independent.

3.67 In the preceding paragraphs the Committee considered the arguments put before that the court should be able to block a compulsory acquisition on the basis of previous actions by the majority shareholder. The same arguments can be applied to the question of whether the valuation of the minority interests should be amended in the light of previous actions of the majority shareholder or some overall assessment of reasonableness. The Committee does not believe that any inappropriate or illegal actions by a majority shareholder should form the basis of an increased valuation of the minority interests. These matters are dealt with elsewhere in the Corporations Law. Similarly, the introduction of a test for the valuation based on whether it is reasonable under the circumstances could give rise to protracted litigation and legal uncertainties.

3.68 The Bill itself creates an incentive for the majority shareholder to offer a fair value for the securities. The Bill provides that if more than 10% of the minority shareholders disagree with the compulsory acquisition the majority shareholder will have to seek approval from the court. The Bill places the onus on the majority shareholder to prove that the terms set out in the compulsory acquisition notice give a fair value for the securities. The Bill further provides that the majority shareholder must bear its own costs and those of the minority shareholder unless the court is

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35 Companies and Securities Advisory Committee, *Compulsory Acquisitions and Buy-outs*, March 1999, p 2.

36 Companies and Securities Advisory Committee, *Compulsory Acquisitions and Buy-outs*, March 1999, p 3.

satisfied that that person acted improperly, vexatiously or otherwise unreasonably.[37] The Committee feels that these provisions create a powerful incentive for a majority shareholder to appoint a reputable independent expert and to make an attractive offer to minority shareholders.

Other issues

3.69 A number of other minor issues were raised during the inquiry. One proposal was that section 661B, which sets out the requirements for compulsory acquisition notices, could be amended so that the notice is required to draw the readers' attention to their rights under sections 661E and 661D. The Committee supports the inclusion of this information in the notice.

Recommendation

3.70 The Committee recommends that the compulsory acquisition notice required by section 661B be required to draw the readers' attention to their rights under sections 661E and 661D.

3.71 The Australian Shareholders' Association has pointed out that a notice to the holders of convertible securities under section 665B is not required to include the additional information given to recipients of compulsory acquisition notices under the compulsory acquisition powers set out in section 664C(1)(c)-(e). The Committee considers that this is a deficiency in the Bill.

Recommendation

3.72 The Committee recommends that a notice to the holders of convertible securities under section 665B be required to include the additional information given to recipients of compulsory acquisition notices under the compulsory acquisition powers set out in section 664C(1)(c)-(e).

3.73 Sections 663C and 665C of the Bill both allow the court, upon application by a holder, to make orders about the terms on which convertible securities can be bought out. It has been suggested that those orders should be applied to all securities of the same class, thereby ensuring that there is only one court determination. This would be consistent with the approach taken elsewhere in Chapter 6A. The Committee supports this view.

Recommendation

3.74 The Committee recommends that sections 663C and 665C be amended so that any court order made under those sections applies to all securities of the same class.

37 Section 664F.

Effect of CGT on Takeovers

3.75 During the Committee's public hearing in Sydney a number of witnesses expressed concerns about the effects of capital gains tax (CGT) on shareholders whose shares are acquired during a compulsory acquisition.[38] Mr Jarrett explained the problem faced by shareholders:

> In any compulsory acquisition situation you will have shareholders who have not wanted to have their shares taken over. But, under the current capital gains tax provisions, not only will the shares be taken from them in the compulsory acquisition but, in fact, the tax liability will arise by virtue of the current provisions that apply to capital gains tax.[39]

3.76 Discussion on this issue also encompassed the effect of capital gains tax on the willingness of shareholders to accept a takeover offer. The evidence to the Committee focused particularly on the effects on self-funded retirees who are considering a scrip for scrip offer.

> It is particularly an issue for self-funded retirees because they are relying on an income stream which comes from their capital base. If they are subject to capital gains tax liability, then their capital base will be diminished and therefore their income stream will be diminished, even though they have continued their investment, so to speak, through the merged vehicle. So it is quite a serious issue for people who are relying on the income stream from their shareholdings.[40]

3.77 The Committee also heard that in a merger the burden of facing an immediate capital gains tax obligation falls on the shareholders of only one company.

> The other serious concern we have about capital gains tax is that in those types of circumstances you have two different sets of shareholders: you have the shareholders in the bidding vehicle and the shareholders in the target. The shareholders in the target are subject to compulsory acquisition and a capital gains tax liability. Those in the bidding vehicle do not get any tax liability at that time. In fact, it is quite a big concern in friendly mergers, such as some of the bank mergers and the like between regional banks and some of the major national banks that have been taking place.[41]
>
> Advance Bank and St George are particularly relevant here, because you had two companies of more or less equal size who wanted to merge. Because the acquiring company was St George, it meant that the Advance Bank shareholders paid the capital gains tax and the St George shareholders

38 Mr John Jarrett, Mr Gordon Elkington, Mr Ted Rofe, Dr Gordon Elkington; Committee Hansard, 22 January 1999.

39 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 109.

40 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 110.

41 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 110.

> did not. If it had been the other way around, it would have been the reverse. What you had was a merged group with a common group of shareholders who continued holding equity in the merged group. They had not sold their shares; they were just forming part of a larger group.[42]

3.78 The witnesses before the Committee said that these problems were a major impediment to takeovers in Australia.

> I understand from the Bank of Melbourne merger that over 50 per cent of the objections were related to the capital gains tax issue. Also, the recent AMP-GIO takeover seems, from media reports, to be a clear example of the fact that a lot of small shareholders decided not to accept the takeover bid because they were very concerned about capital gains tax. In fact, I was speaking to someone who was a shareholder and that was pretty much the prime issue. They looked at their shareholding before the takeover and after the takeover and, with the capital gains tax liability, they had less and they were going to have less of an income stream, and they said, `I don't want any of that,' despite what the price was. We think it is a very serious problem. In Western economies, Australia is almost totally isolated on this issue. Nearly all other jurisdictions have a form of rollover relief which is reasonably easy to access.[43]

> Tax has the potential, if it is not changed, to undermine the good work that the current bill is doing by enabling business conduct to be more efficient. If there is not a CGT rollover relief introduced, while the mechanisms of the takeover law and takeover procedures may be streamlined, the impediments on the offers will still be there because, where there are share-for-share exchanges, there will be a major detriment on behalf of the offeree in accepting the offer.[44]

3.79 In concluding his evidence Mr Jarrett said that:

> The institute is a strong supporter of implementing rollover relief of capital gains tax in share swap merger situations, regardless of whether they involve compulsory acquisition or not.[45]

3.80 The Committee has also noted that this issue is being considered by the Review of Business Taxation. In its discussion paper the Ralph Committee also mentioned many of the points which were raised in evidence before the Committee.[46] In its discussion paper that Committee said:

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42 Mr Ted Rofe, Australian Shareholders' Association, Committee Hansard, 22 January 1999, p 154.

43 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 110.

44 Mr Ronald Forster, Australian Institute of Company Directors, Committee Hansard, 22 January 1998, p 139.

45 Mr John Jarrett, Securities Institute, Committee Hansard, 22 January 1999, p 109.

46 Review of Business Taxation, *A Platform for Consultation*, Discussion Paper 2 Volume 1, February 1999, pp 294-298.

> Where a scrip-for-scrip merger or takeover occurs, the CGT provisions are currently triggered because the taxpayer has disposed of one asset for another, even though there has been no realisation of cash. Countries that allow rollover do so on the basis that the cost base has not changed and the shareholder has a continuing interest in the same assets together with those combined through the merger. If the transaction is wealth generating the tax ultimately collected is greater since the original cost base is retained.[47]

3.81 The Committee is of the view that the capital gains tax implications of accepting a takeover offer will deter many of investors from accepting an offer. The effect of this will be to frustrate, to a significant extent, the economic objectives of the reforms contained in this Bill. The Committee is also concerned that the absence of roll over relief may have a deleterious effect on the ability of many self-funded retirees to continue to independently support themselves. It also accepts that compulsory acquisitions are confiscatory in nature, albeit beneficial in the overall context. However, in principle and in practice such confiscation should not trigger a capital gains tax liability. For these reasons the Committee considers that it would be appropriate for roll over relief to be provided where shares are compulsorily acquired and in the case of scrip for scrip offers for publicly listed companies, irrespective of the revenue implications for the Government of such an initiative.

Recommendation

3.82 The Committee recommends that, irrespective of progress on other much needed capital gains tax reform, roll over relief from Capital Gains Tax be provided where shares are compulsorily acquired and when a takeover offer for a publicly listed company is accepted on a scrip for scrip basis. An amending tax bill should be introduced urgently to accompany debate on this legislation to give effect to this recommendation. Failing this, the legislation should be amended so that a potential, unwanted capital gains tax liability provides an absolute defence against compulsory acquisition.

Nominee for foreign holders of securities

3.83 Under the current law, where the consideration for a takeover bid includes an offer of securities the bidder must appoint a nominee to receive the offer on behalf of foreign holders. That nominee must be approved by the company's home stock exchange or, where the company is not a listed company, by the ASIC.[48] The provisions of the Bill are consistent with the existing law.[49]

3.84 The ASX has said that the person approving the nominee in all cases should be the ASIC. It says that it has no particular expertise in approving nominees and the

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47 Review of Business Taxation, *A Platform for Consultation*, Discussion Paper 2 Volume 1, February 1999, p 294.

48 Section 621(3).

49 Sections 615(a) and 619(3).

approval is for the purposes of the Corporations Law.[50] In response to this proposal the Australian Shareholders' Association has said that it has no objection to the ASX's proposal.[51]

3.85 The ASX proposal appears to be reasonable to the Committee and would simplify the legislation. It does not appear to the Committee that the proposal would lead to any reduction in investor protection or would undermine in any way the objectives of the legislation.

Recommendation

3.86 The Committee recommends that sections 615 and 619 of the Bill be amended to require that the nominee be approved in all cases by the ASIC.

50 Australian Stock Exchange, Submission 5c.

51 Australian Shareholders Association, Submission 20b, p 5.