

# CHAPTER 1

## INTRODUCTION

### Background

1.1 The *Corporate Law Economic Reform Program Act 1999* re-wrote the takeover provisions of the Corporations Law, with the new provisions coming into force on 13 March 2000.

1.2 The Explanatory Memorandum for the CLERP Bill advised of the objectives of the proposed takeover reforms:

The Takeover 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 ultimately to greater wealth creation. The reforms are aimed at ensuring that these incentives operate effectively.<sup>1</sup>

1.3 The CLERP Bill included provisions for a Mandatory Bid Rule (MBR), under which a prospective purchaser would be permitted to exceed the statutory takeover threshold of 20 per cent of the total voting rights in a company before being required to make a full takeover bid. The Explanatory Memorandum noted that prospective purchasers would be able to choose the type of takeover procedure most suited to achieving their objectives and that all shareholders of the target company would have an equal opportunity to exit the company at a fair price.<sup>2</sup> The new rule would require the acquirer to offer the same bid price to all shareholders, regardless of whether they held controlling interests or not.

1.4 Other jurisdictions have adopted a MBR. For instance, France, Germany and Ireland have enacted a MBR, although with different threshold limits, following an EC Commission directive proposing the adoption of the MBR.<sup>3</sup> As noted in the Explanatory Memorandum, the archetype for the MBR is the UK *City Code on Takeovers and Mergers*, which is a self-regulatory code. In the UK, the MBR has

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1 Explanatory Memorandum, paragraph 1.4.

2 Explanatory Memorandum, paragraph 7.4.

3 See *The Amended Proposal for a Thirteenth Council Directive on Company Law, Concerning Takeover and Other General Bids* (1997). In the UK and Ireland, the takeover threshold is specified as 30 per cent of the voting equity, and 33 per cent in France. In Germany and in the EC Commission directive, a threshold is not defined in shareholder percentage terms (see Hutson E, *An International Comparison of Takeover Regimes*, February 2000, commissioned by the Securities Institute of Australia and tabled at the PJSC hearing on 15 March 2000).

operated since the introduction of the *City Code* in 1968. The adoption of a MBR has also been analysed in the literature and policy documents.<sup>4</sup>

1.5 The rationale behind the MBR is the need for protection of minority shareholders who might be compromised in takeovers. According to Mr Peter Lee, Deputy Director-General of the UK Panel on Takeovers and Mergers, the MBR present in the *City Code* is derived from the principle that “shareholders should be given the chance to sell out of the company as they may have a low opinion of the new controller’s business ability or methods, or they might not wish to remain in a company which had, say manufactured cars and was now to produce armaments” and the view that “the passing of control usually involves the payment of a premium over the market price. It is thought that all shareholders, not just the controller, should share the premium.”<sup>5</sup>

### **Mandatory Bid Rule as proposed in the CLERP Bill**

1.6 Under the CLERP provisions, the acquisition of shares beyond the holding of 20 per cent of the total voting rights in a company would be permitted so long as the acquisition is immediately followed by the announcement of a full takeover bid.<sup>6</sup> The provisions also imposed certain conditions for the protection of minority investors even where, at the time the mandatory bid is made, the prospective purchaser has gained a controlling position.

1.7 The following conditions would apply to a mandatory bid, including a number of general conditions that apply to takeover bids:

- the bidder must start from below the 20 per cent threshold with only one acquisition being allowed before the mandatory bid is triggered (section 611 item 5(d));
- the bidder should not acquire a relevant interest in any other securities of the target company at the same time as the acquisition triggering the mandatory bid (section 611 item 5 (c));
- the bidder must disclose to the vendor that the mandatory bid will be triggered by an agreement to sell (section 611 item (f));
- the takeover bid must include a cash offer for the securities. It may also include an offer either of securities, or cash and securities, as an alternative (section 621(2));

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4 For recent discussion of the MBR see Bergstrom C, Hogfeldt P and Molin J, “The Optimality of the Mandatory Bid Rule”, *Journal of Law, Economics and Organisation*, Vol 13, 1997, pp 433-451; Corporate Law Economic Reform Program: Proposals for Reform: Paper No. 4: *Takeovers*, 1997; Calleja N, “The Equality Principle and Prohibited Benefits in Takeovers”, *Australian Business Law Review*, Vol 27 (5), October 1999, pp 342-363; and Brown P and da Silva R, “Australia’s Corporate Law Reform and the Market for Corporate Control”, *Agenda*, Vol 5 (2), 1998, pp 179-188.

5 Mr Peter Lee, Committee Hansard, 15 March 2000, CS 1.

6 Section 611 item 5(e).

- the bid price must be for an amount at least equivalent to the highest price paid by the prospective purchaser in cash or non-cash transactions in the last four months (section 621(4));
- the takeover bid must be unconditional (section 611 item 5(e));<sup>7</sup>
- target shareholders must be provided with an independent expert's report by the target (section 640(1)(d));
- the bidder must not exercise control of the target until the offer period starts for the mandatory bid (section 614(1)(b));
- no securities will be able to be issued in the target, or dividends declared or distributions made, from the time of the pre-bid acquisition until the end of the bid period without shareholder approval by a general meeting (section 614(1) (c) and (d));
- the bidder must demonstrate in its statement to target shareholders that the bid is adequately funded (section 636(1)).<sup>8</sup>

### **PJSC report on the MBR**

1.8 On 10 December 1998 the Senate referred the provisions of the CLERP Bill to the Parliamentary Joint Statutory Committee on Corporations and Securities (PJSC) for inquiry and report.<sup>9</sup>

1.9 On 12 May 1999 the PJSC tabled its report on the Corporate Law Economic Reform Program Bill 1998.<sup>10</sup> The PJSC supported the introduction of the MBR, without amendment, on the basis that it would lead to greater takeover activity and would ensure that target shareholders would have the opportunity to sell their shares on the same terms as the single, pre-bid acquisition.

1.10 The PJSC also considered whether the MBR should be extended to conditional mandatory bids as suggested by the Australian Institute of Company Directors (AICD). The AICD contended that the ability to make a conditional mandatory bid was fundamental to a takeover bid. However, the PJSC did not agree:

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7 The mandatory bid must be fully unconditional unless approved by the Australian Securities and Investments Commission under its power to exempt and modify a takeover offer (section 655A).

8 A number of the above conditions were incorporated in the then draft Corporate Law Economic Reform Bill 1998 following a submission from the Australian Securities and Investments Commission to Treasury, in response to the Corporate Law Economic Reform Program: Proposals for Reform: Paper No. 4: *Takeovers*, 1997. See Australian Securities and Investments Commission, Submission 3, which includes an extract of the submission to Treasury.

9 *Journals of the Senate*, No 15, 10 December 1998.

10 See Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Law Economic Reform Program Bill 1998*, May 1999.

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 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 bids.<sup>11</sup>

1.11 The PJSC, however, noted that the CLERP Bill provided for the Government to review the operation of the new rule two years after its commencement. It concluded that this would be an appropriate time to review the requirement that mandatory bids be unconditional.

1.12 During parliamentary debate on the CLERP Bill in October 1999, the Senate removed the provisions in the Bill introducing the MBR.<sup>12</sup>

### **The Committee's inquiry**

1.13 On 7 December 1999, the Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, requested the PJSC to inquire into whether it was appropriate to amend the Corporations Law to include a mandatory bid rule, similar in terms to that proposed in the Bill. As a result of that request the PJSC agreed to re-examine the proposed introduction of the MBR.

1.14 The PJSC advertised its inquiry on 7-8 January 2000 and called for submissions by 4 February 2000. The PJSC received 12 written submissions, which in general supported the introduction of the MBR. A list of organisations and individuals who made submissions is included at Appendix 1 to this Report. The PJSC also held two public hearings and a list of witnesses who appeared before the PJSC is included at Appendix 2.

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11 Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Law Economic Reform Program Bill 1998*, May 1999, pp 11-12.

12 Hansard, *Senate*, 13 October 1999, P9253.