return to AMPLA 2001 Table of Contents

Recent Developments in Regulation of Australian Takeovers

Marie McDonald*

SUMMARY

This paper reviews three sources of developments in Australian takeover laws. First, it examines some of the more significant changes to Australian takeover laws which were effected by the Corporate Law Economic Reform Program Act, which commenced operation on 13 March 2000. These changes had implications for the consideration to be paid for a pre-bid stake, the content of takeover documents and the need for supplementary takeover documents, automatic extensions of bids, compulsory acquisition and, significantly, rejuvenation of the Takeovers Panel.

Secondly, the paper outlines some other takeover mechanisms which, with the concurrence of regulators, have been used as alternatives to a formal takeover bid under Ch 6 of the Corporations Act. These mechanisms include schemes of arrangement, capital reductions and dual listed companies.

Lastly, the paper reviews a recent development in Australian mergers and acquisitions activity, being the emergence of break fee agreements. Such agreements are common in the United States and United Kingdom, but have only recently appeared on the Australian takeover scene.

CHANGES TO TAKEOVER LAWS

The *Corporate Law Economic Reform Program Act* (CLERP), which commenced operation on 13 March 2000, implemented reforms to a number of areas of the *Corporations Law* (as it was then called).[1] In

* Bsc (Hons), LLB(Hons) (Melb); Blake Dawson Waldron, Lawyers, Melbourne.

[1] The *Corporations Act* 2001 (Cth) replaced the *Corporations Law* with effect from 15 July 2001.

particular, CLERP substantially re-wrote the takeover laws. The new laws sought to correct some longstanding anomalies, some of which were identified by the Legal Committee of the Companies and Securities Advisory Committee in a report called "Anomalies in the Takeover Provisions of the *Corporations Law*" published in March 1994. In addition, CLERP made some substantive changes to the regulation of takeovers, including, in particular, the reincarnation of the Corporations and Securities Panel (known as the Takeovers Panel). Set out below is a summary of some of the substantive changes, together with comments on their actual impact.

Building a Pre-Bid Stake

A potential bidder can obtain a strategic advantage by acquiring shares up to the 20 percent threshold permitted by Australian takeover laws before launching the bid. The pre-bid stake may discourage potential competing bidders and can give the bidder a profitable exit if it is overbid.

The old takeover laws contained some restrictions on the terms which a proposing bidder could offer under its bid if it had previously acquired a platform of shares. First, if the bidder offered a cash consideration under its bid, the cash had to be not less than the price the bidder had paid to acquire a platform of shares in the four months prior to dispatch of takeover offers. Secondly, a proposing bidder could not offer a benefit to acquire a platform of shares if it was not proposing to provide that benefit under a takeover bid to be made by it in the next four months.

The combined effect of the above rules was that a proposing bidder could not acquire a platform of shares for cash by private purchase from a major shareholder if the proposing bidder was not intending to provide cash under its takeover bid. There was a loophole, however, in that the proposing bidder could acquire shares in the ordinary course of trading on market for cash and yet offer a less valuable scrip consideration under its takeover bid.

The *Corporations Act* now permits a pre-bid stake to be acquired for a different consideration to that offered under the bid, provided that the consideration offered under the bid is equal to or greater than the maximum consideration provided by the bidder or an associate during the four months prior to the date of the bid (s 621(3)). Accordingly, it is now possible for a bidder to buy a pre-bid stake for cash and offer its own shares as consideration under the bid. It is also possible (but less likely) that a bidder could acquire a pre-bid stake for a non-cash consideration (for example,

an asset/share swap) and then offer cash as consideration under the bid.

In practice, there have not been many examples of bidders differentiating between the consideration offered for a pre-bid stake and under the takeover offer. This may be due to concerns about the effect of share market movements. If a bidder acquires a pre-bid stake for cash but wishes to offer its own shares under a bid, it must ensure that the monetary value of those shares is not less than the cash which it offered for the pre-bid stake. If there is a drop in the share market after the pre-bid acquisition, the bidder will need to offer additional scrip or cash consideration under its bid to ensure it is offering the same monetary value. This applies, even if there is a drop in the share market which affects shares in the target and bidder equally.

The issue is exacerbated by the fact that the bid consideration must be valued at the date offers are made (that is dispatched), which will generally be at least 14 days after the date of the takeover announcement. Accordingly, a bidder is exposed to the risk that the share market will drop between the date of its takeover announcement and dispatch of offers (and the bidder will need to top up its takeover consideration with more scrip or cash). Although ASIC has issued a class order providing some relief from this requirement (permitting the bidder's scrip consideration to be valued up to five business days before dispatch of offers),[2] there are still significant risks for a bidder who pays cash for a pre-bid stake and then wishes to offer its own scrip as takeover consideration.

Automatic Extension of Bids

Under the old takeover laws, the price under an unconditional bid could be increased late in the offer period. Institutions were able to react quickly and accept such increased offers, leaving the retail investors locked in.

Section 624(2) now provides for an automatic 14 day extension of the offer period if the bidder increases its offer consideration, or the bidder's voting power increases to more than 50 percent, during the last week of the bid. The 14 day extension runs from the date the consideration was increased, or the bidder passed the 50 percent threshold. This automatic extension has been quite common in practice (particularly, by reason of the bidder passing through the 50 percent control threshold).

[2] ASIC Class Order 00/2338. See also ASIC Policy Statement 163 and Corporations and Securities Panel Policy on the Minimum Price Requirement – S 621(3) and (4), March 2000.

Content of Bidder's Statements and Target's Statements

The old provisions of the *Corporations Law* were quite prescriptive about the content of Part A and Part C Statements (as bidder's statements were then called) and Part B and Part D Statements (as target's statements were then called). Section 750 of the *Corporations Law* set out a list of matters which had to be addressed in those statements, in addition to containing an overriding requirement that the relevant statement set out any other information material to the making of a decision by an offeree whether or not to accept the offer, being information known to the bidder (for a Part A or C Statement) or directors of the target (for a Part B or D Statement), which had not previously been disclosed to target shareholders.

Section 636 of the *Corporations Act* now contains a more refined list of matters which a bidder's statement must address, although there is still an overriding requirement to include any other information known to the bidder that is material to the decision by a holder of bid class securities whether to accept the offer. The list of matters which a bidder's statement must still address include, importantly, the bidder's intentions, the source of any cash consideration, details of purchases of bid class securities by the bidder or an associate in the last four months and prospectus quality information in relation to any scrip consideration. In the case of a target statement, the requirements of the *Corporations Act* are even more limited – s 638 requires only that the target's statement contain the directors' recommendation, together with all information known to any target director that holders of bid class securities and their professional advisers would reasonably require to make an informed assessment whether to accept the offer or not.

Although the *Corporations Act* is less prescriptive concerning content, many practitioners still used the *Corporations Law* "shopping list" in s 750 as a guide in the preparation of the takeover documents in the period immediately after introduction of CLERP. As time has elapsed, however, and practitioners have become more comfortable with the operation of the new laws and the Panel's commercial approach to the content of such documents, takeover documents are more likely to depart from the requirements of the old s 750.

It is also noticeable that the presentation of bidder's statements has changed. The *Corporations Act* recognises that it is not necessary to have a separate offer document and bidder's statement – they can be combined in the one document. Accordingly, most modern takeover documents tend to combine the "offer" and statutory bidder's statement in the one document (which is then often interwoven with

other non-statutory information from the bidder seeking to encourage acceptance of the bid).

Supplementary Statements

The *Corporations Act* now requires that a bidder or target up-date its bidder's or target's statement if it becomes aware that there is a misleading or deceptive statement in its original statement or there is an omission from that statement or if new circumstances arise which would have been material for inclusion in that statement if they had arisen before the document was lodged (and the new circumstances are material from the point of view of a holder of bid class securities) (ss 643 and 644). If a supplementary statement is required, a copy must be lodged with the Australian Securities and Investments Commission (ASIC) as well as being given to the target or bidder as soon as practicable (s 645). Where the bid class securities are listed, a copy of the supplementary statement must also be given to the Australian Stock Exchange (ASX). Except in the case of unlisted securities, there is no requirement to send a supplementary statement to target shareholders.

Under the old provisions of the *Corporations Law*, there was no requirement for a bidder or target to up-date its Part A or Part B Statement. If a bidder became aware of information which was price sensitive to the target company's securities, but which was not generally available, the bidder would normally have announced that information to ASX (or procured the target to do so), to avoid allegations of insider trading.

Since the introduction of the requirement for supplementary statements, a number of such statements have been prepared. In some cases, a supplementary bidder's statement has been prepared in response to complaints by the target about the adequacy of the original bidder's statement. The incidence of supplementary statements during the course of a bid may also have been influenced by the attitude of the target company. Where the target company is hostile, the bidder is more likely to pre-empt complaints from the target by lodging a supplementary bidder's statement.

In many cases, supplementary bidder's statements have been prepared in relation to information which is already the subject of a notice required under the takeover laws or which has already been disclosed to ASX pursuant to the bidder's continuous disclosure obligations. Supplementary statements have dealt with matters such as increased offer consideration, adding an alternative offer consideration, extension of the offer period, the status of conditions

(particularly progress towards obtaining regulatory approvals), Australian Taxation Office rulings concerning the bid consideration (which are often received some time after the bidder's statement has been dispatched), and the bidder's half-yearly or yearly results. In some cases, bidder's supplementary statements have addressed various events relating to the bid itself, including, for example, the emergence of a competing bid, the fact that the bidder or target may have made an application to the Takeovers Panel and reporting on the outcome of any application to the Takeovers Panel. In the case of scrip bids (where the financial position, prospects and assets and liabilities of the bidder are particularly relevant to target shareholders), there have been a number of instances of supplementary bidder's statements disclosing that the bidder has entered into a significant transaction (although such announcements are generally the subject of a separate release by a listed bidder under its continuous disclosure obligations). There have been very few cases of a bidder issuing a supplementary statement which addresses a forward looking statement such as an earnings forecast or statement of outlook in its original bidder's statement.

Supplementary target statements are less common and have tended to be prepared in response to a change in the bid (for example, improved consideration being offered or a competing bid emerging).

It is doubtful that the requirement to prepare supplementary statements has increased the quality of information released by bidders or targets to ASX. In many cases, the supplementary statement has merely replicated information which has either been released to ASX in performance of other obligations or which has been the subject of direct correspondence by the bidder/target to shareholders. The real test will be when an unlisted bidder offering scrip consideration suffers a material downturn in its prospects. If not for the requirement to issue a supplementary statement, the bidder may not have been obliged to disclose that information to the target shareholders.

Compulsory Acquisition

The *Corporations Act* permits a bidder under a takeover bid to compulsorily acquire any securities in the bid class if the bidder and its associates come to have a relevant interest in 90 percent or more of the securities (either during or by the end of the period) and they have acquired at least 75 percent (by number) of the securities the bidder offered to acquire under the bid. The 75 percent test, which focuses on the number of outstanding shares, is more liberal than the

old three-quarters test. The old test (which applied where the bidder was already entitled to 10 percent of the bid class securities when the offers were dispatched) required that at least three-quarters of the offerees (on a head count basis) disposed of their shares to the offeror, or that they not be on the target company share register within one month of the end of the offer period. Because the new 75 percent test focuses on the numbers of shares outstanding, it only becomes relevant if the bidder and its associates own more than 60 percent of the target at the commencement of the bid. One instance of this occurring was in Rio's mop up bid for Comalco in 2000, where a Rio subsidiary already owned more than 72 percent of Comalco. It was necessary for Rio to acquire relevant interests in 93 percent, rather than 90 percent, of Comalco shares before it could move to compulsory acquisition.

Of greater potential significance, has been the introduction of a general compulsory acquisition power into Pt 6A.2 of the *Corporations Act*. It permits compulsory acquisition by a "90 percent holder" within six months after the person became a "90 percent holder". It is not necessary that the acquisition follow a takeover bid.

These provisions permit a "90 percent holder" to compulsorily acquire all outstanding shares or securities convertible into shares (for example, options). A "90 percent holder" who wishes to acquire convertible securities must have voting power in the target company of at least 90 percent and must hold, either alone or with a related body corporate, full beneficial interests in at least 90 percent by value of all securities of the company that are either shares or convertible into shares (s 664A(2)).

A "90 percent holder" who wishes to utilise these provisions must obtain a report from an independent expert stating whether the proposed consideration is fair value for the securities concerned. The expert must be nominated by ASIC (normally ASIC will provide a list of three experts from whom the acquirer may choose). If a "90 percent holder" chooses to utilise these provisions, compulsory acquisition will proceed unless the holders of 10 percent of the remaining securities object within a one month period after notice is given to them. If such an objection is made, the "90 percent holder" cannot proceed with the compulsory acquisition without obtaining court approval to the acquisition. The court is required, however, to approve the acquisition, on application by a "90 percent holder", if the "90 percent holder" establishes that the proposed acquisition terms give a fair value for the securities.

Fair value for the outstanding securities is to be determined by assessing the value of the company as a whole and then allocating that value among the various classes of issued securities (taking into

account the relative financial risk, and voting and distribution rights, of the classes). The value allocated to each class is then to be allocated pro rata among securities in that class (without allowing a premium or applying a discount for particular securities in the class) (s 667C(1)).

There have been some differing views expressed on the precise meaning of s 667C.[3] It does seem, however, that any benefits accruing to the acquirer as a result of gaining 100 percent (including, for example, taxation benefits and savings on administrative expenses) should be taken into account in valuing the company as a whole and should then be allocated among the classes (and the allocation should be pro rata within a class, that is, any special benefit attributable to acquiring 100 percent should not be allocated solely to the minority shares).

Contrary to expectation, the general compulsory acquisition powers have not been frequently used by "90 percent holders" to successfully mop up outstanding securities. This is not for want of trying – a number of "90 percent holders" have given compulsory acquisition notices to minority shareholders. In many cases, however, holders of 10 percent of the remaining securities have given objection notices and the "90 percent holders" have been forced to apply to the courts for approval to the acquisition. Decisions on those applications are pending. It may be that once a sufficient body of case law exists on the operation of these provisions, minority shareholders will be less inclined to object. It should be noted, however, that the legislation does not discourage minority shareholders from objecting – the "90 percent holder" is liable to pay the costs of the minority shareholder (unless the court is satisfied that the minority shareholder acted improperly, vexatiously or otherwise unreasonably (s 664F(4)).

One practical difficulty with the general compulsory acquisition powers is that the necessary compulsory acquisition notice must be given within six months of the "90 percent holder" becoming a "90 percent holder". This means that if a "90 percent holder" gives a compulsory acquisition notice which is unsuccessful (because the holders of 10 percent of remaining securities object and the "90 percent holder" either does not apply to court for approval or applies to court but is rejected), the "90 percent holder" may be out of time to try again (by giving a further notice for an increased consideration). ASIC has indicated that it will give relief to effectively "stop the clock" in circumstances where a "90 percent holder" gives a compulsory acquisition notice within the six month period but the minorities object.

[3] *Winpar Holding Ltd v Goldfields Kalgoorlie Ltd* (2000) 18 ACLC 665; *Pauls Ltd v Dwyer* [2001] QSC 067.

To take advantage of such relief, it is necessary to obtain the modification from ASIC before the six month period expires. It is ASIC policy not to (and indeed ASIC considers that it does not have power to) modify the *Corporations Act* once the six month period has expired.

It should also be noted that the general compulsory acquisition provisions can also be used in non-public company situations, such as where a person acquires more than 90 percent of a privately owned company. In the case of an incorporated joint venture, for example, a person who moves from, say, a 50 percent interest to a 90 percent interest can compulsorily acquire the remaining shares (provided it can be demonstrated to a court that the price is fair, should outstanding shareholders object).

The Takeovers Panel

One of the most significant changes to the process for launching a bid has been the revamping of the Corporations and Securities Panel (known as the Takeovers Panel). Previously, hostile takeovers had been plagued by tactical litigation, designed to slow down the bid and give the target time to find alternative bidders or to force the bidder to pay a higher price. This was particularly the case where scrip consideration was offered, because prospectus quality disclosure was required.

The opportunities for such tactical litigation have been significantly reduced as a result of the role played by the Corporations and Securities Panel. That Panel has (almost)[4] exclusive jurisdiction to hear proceedings in relation to an action taken as part of, or for the purposes of, a takeover bid or a target's response to the bid or in relation to any document prepared or given under Ch 6 of the *Corporations Act* (which is the chapter governing takeover bids). Only ASIC, or another public authority, is permitted to commence court proceedings in relation to a takeover bid or proposed bid before the end of the bid period.

The Panel has power to declare circumstances in relation to the affairs of a company to be unacceptable circumstances. The Panel may make such a declaration only if it appears to the Panel that the circumstances are unacceptable:

- having regard to their effect on:
  - the control, or potential control, of the company (or another company); or

[4] The High Court still has jurisdiction to review Panel decisions under s 75(v) of the Constitution.

– the acquisition, or proposed acquisition, by a person of a substantial interest in the company (or another company); or

- because they constitute, or give rise to, a contravention of Chs 6, 6A, 6B and 6C (s 657A(2)).

It is not necessary therefore that a breach of the takeover laws, or indeed of the common law, occur before the Panel is able to make a declaration of unacceptable circumstances. In exercising its powers, the Panel must have regard to the purposes of Ch 6 which are set out in s 602. These are to ensure that:

- the acquisition of control over a company takes place in an efficient, competitive and informed market;
- shareholders in, and directors of, the target company know the identity of a person who proposes to acquire a substantial interest in that company, have a reasonable time to consider the proposal and are given enough information to enable them to assess the merits of the proposal;
- so far as practicable, target shareholders have a reasonable and equal opportunity to participate in any benefits accruing to target shareholders under a proposal which would result in a person acquiring a substantial interest in the company;
- an appropriate procedure is followed as a preliminary to compulsory acquisition of securities under Pt 6A.1 (being the compulsory acquisition provisions applicable immediately following a takeover).

In one case, (*In the matter of Pinnacle VRB Ltd (No 5)*)[5] the Panel formulated a policy which had not previously been part of the common law or statute law. The policy was that, in general, a transaction or conduct by a target board which has the effect of triggering a bid condition that is likely to lead to defeat of the bid must be submitted to the target members for approval. This was on the basis that target shareholders would otherwise be deprived of a "reasonable and equal opportunity to participate in any benefits accruing under the bid". In formulating this policy, the Panel acknowledged that it was creating a new set of rights and obligations between parties, rather than seeking to enforce existing ones (the latter being the role of the courts).

Likewise, the Panel has issued a draft policy on lock-up devices,[6] in which it acknowledges that the validity of lock-up devices under general law or statute law is not its principal concern. Rather, the Panel is concerned with whether a lock-up device might constitute

[5] Affirmed by a Review Panel in *In the matter of Pinnacle VRB Ltd (No 8)* (2001) 19 ACLC 1, 252.
[6] Corporations and Securities Panel draft "Policy on Lock-up Devices", August 2001.

unacceptable circumstances, particularly because of any anti-competitive effects it may have on the market (that is, would the arrangement inhibit an acquisition of control occurring in an "efficient, competitive and informed market"?).

The Panel's jurisdiction is not confined to takeover matters, and it can make a declaration of unacceptable circumstances where control changes, or a person acquires a substantial interest, other than through a takeover bid. Accordingly, the Panel could make such an order in relation to explanatory material provided as part of the process for obtaining shareholder approval to a scheme of arrangement or dual listed companies structure. The Panel has, however, indicated that it will generally be inappropriate for the Panel to conduct proceedings in relation to an application where the evidence and issues are already before the court (which would often be the case for a scheme of arrangement).[7]

The Panel's preference for permitting dispatch of documents (unless the deficiencies in them are such that they cannot be adequately remedied by the bidder sending supplementary material or correction in the target's statement),[8] has resulted in a significant change to the unfolding of the first few weeks of a takeover bid. A target company (or more relevantly, its advisers) will be aware that it must raise any concerns about a bidder's takeover documents within the first week or so of the bid and that, except in unusual cases, the takeover documents will be dispatched within two weeks after service (although there may be some supplementary material sent if the target presses its concerns). Accordingly, a target company must immediately focus on the merits of the bid, rather than hoping to "buy time" by instituting legal proceedings.

It is also worth noting that the Panel has indicated on two occasions that it is desirable (although not compulsory) for takeover documents issued by a mining company to comply with the JORC Code (issued by the Joint Ore Reserves Committee of The Australasian Institute of Mining and Metallurgy, the Australian Institute of Geoscientists and the Minerals Council of Australia). In *Namakwa Diamond Company NL (No 2)*[9] and in *Taipan Resources NL (No 10)*,[10] the Panel recognised that the terms recommended by the JORC Code for description of mineral resources and ore reserves have become standard usage in publications by listed companies, and that material departures from them risk being misleading. The

[7] *Re Taipan Resources NL (No 2)* (2000) 36 ACSR 704.
[8] Corporations and Securities Panel Policy 5 "Restraining the Dispatch of Documents", April 2001.
[9] Unreported, 15 May 2001.
[10] Unreported, 23 May 2001.

Panel stated that it was generally desirable that reporting of mineral resources in takeover documents should, as far as practicable, comply with the JORC Code. Accordingly, novel concepts such as "mineable resource" (which was the expression used in the bidder's statement in the *Namakwa* case) should be avoided, unless there is a good reason to use such an expression. The Panel in the *Taipan No 10* (and the Review Panel in *Taipan No 11*)[11] did note that a failure to comply strictly with the JORC Code will not necessarily give rise to unacceptable circumstances, provided that the bidder's statement is not materially misleading as a result.

Scrip for Scrip Rollover Relief

One of the most significant changes to the regulation of takeovers in Australia has been effected through changes to the taxation laws, rather than the *Corporations Act*. The *Income Tax Assessment Act* was amended in late 1999 to provide an accepting shareholder with capital gains tax relief where the accepting shareholder exchanges post-CGT shares for shares in the bidder.[12] If the bidder is a member of a wholly owned company group (for exmple in the case of a downstream acquisition), the replacement shares must be in the ultimate parent company rather than the bidder. It is a condition of the relief that the bidder make an offer on substantially the same terms to all shareholders in the target company to acquire their shares and that, as a consequence of the offer, the bidder must have obtained a holding of at least 80 percent of the voting shares in the target company (which can include the shares held before the bid by the bidder and/or any other companies in the same wholly owned group as the bidder). The relief also applies to a takeover effected through a scheme of arrangement. Certain additional conditions apply in relation to non-residents.

The relief also applies to an exchange of options, rights or similar interest in the target company for options, rights or similar interests in the replacement company.

If rollover relief is available, an accepting shareholder will not be subject to capital gains tax on a disposal of target company shares. Instead, the CGT cost base of the shares received from the bidder will be determined by reference to the cost base of shares in the target which were exchanged as a result of accepting the offer.

Since relief is not available unless the bidder obtains a holding of at least 80 percent of voting shares in the target, a target shareholder

[11] *In the matter of Taipan Resources NL (No 11)* unreported, 26 June 2001.
[12] Subdivision 124-M, *Income Tax Assessment Act* 1997.

may not know whether relief will be available at the time of accepting the bidder's offer (unless the bidder has already received acceptances from other shareholders which have taken it through the 80 percent threshold). There have been some instances of bidders making their offers conditional on achieving an 80 percent ownership level and stipulating that the condition cannot be waived by the bidder. In such circumstances, the accepting shareholders know that if the bid is successful (and their shares are sold to the bidder) they must obtain CGT rollover relief. Bidders are generally reluctant to include a non-waivable 80 percent minimum acceptance condition, however. This is because most large shareholders and institutions will not accept a bid until it has become unconditional.

If a bidder includes a minimum acceptance condition which it later wishes to waive, the bidder must be careful to ensure that it has not made any representations to target company shareholders that they will necessarily receive CGT rollover relief in respect of accepting shares. If a bidder has made such representations, it may constitute "unacceptable circumstances" for the bidder to subsequently seek to waive the condition.

In practice, the 80 percent threshold is most likely to be crossed (and thus scrip for scrip rollover relief is most likely to be available) in circumstances where the minimum acceptance condition has been waived but the target board has recommended the offer. In such cases there is a high degree of confidence that the bidder will acquire at least 80 percent of shares in the target and, accordingly, the target shareholders will be more willing to accept the offer.

ALTERNATIVE TAKEOVER STRUCTURES

There are a number of means of combining companies, other than through a takeover bid. These include a scheme of arrangement, capital reduction and, most recently, a dual listed company's structure. It is noticeable that in the last few years regulators have been willing to grant modifications to facilitate these alternative takeover mechanisms, provided that certain safeguards are maintained with respect to disclosure and other matters.

Scheme of Arrangement

For example, ASIC has indicated that it will permit a "takeover" to be implemented by means of a scheme of arrangement, provided that shareholders receive treatment and protection which is equivalent

(although not necessarily identical) to that provided under a takeover bid. Accordingly, ASIC expects shareholders to be provided with sufficient time to make a decision about a scheme, shareholders to receive the same quality of information as for a takeover bid and shareholders to have an equal opportunity to share in any benefits that flow from a person acquiring a substantial interest in their company.[13]

A scheme of arrangement between a company and its members requires:

- a court hearing at which the court orders that a meeting of the company's members be held;
- a resolution approving the scheme being passed by the members. The resolution must be passed by a majority in number of those voting at the meeting, being a majority holding at least 75 percent of the votes cast in favour at the meeting; and
- the scheme being approved by the court at a further hearing.

There are advantages to implementing a takeover by way of scheme. These include the lower approval threshold, which need only be satisfied in relation to those actually voting at the meeting. If the necessary resolution is passed, all shareholders in the class are bound, whether they voted for the scheme or not. This can be contrasted with a takeover bid where acceptances for 90 percent of all shares in the class are required before the offeror can proceed to compulsory acquisition. The other advantage of a scheme is certainty as to the implementation date (the scheme documents can specify the date on which the scheme will take effect), together with the "all or nothing" effect. In the case of a takeover bid, an offeror cannot be confident as to when it will achieve 90 percent acceptances (or complete compulsory acquisition).

Accordingly, a scheme may be an attractive alternative takeover structure where the offeror is not concerned about the target company being "in play" for several months between announcement of the scheme and implementation.

[13] ASIC Policy Statement 60. ASIC has a significant role to play in this context. Section 411(17) of the *Corporations Act* provides that the court must not approve a scheme of arrangement unless it is satisfied that the scheme has not been implemented for the purposes of enabling a person to avoid the operation of the takeover laws or a certificate is produced to court signed by ASIC stating it has no objection to the scheme. If ASIC provides such a certificate to the court at the hearing to approve the scheme, the court cannot refuse to approve the scheme on the basis that it should have been implemented by way of takeover (*Re Advance Bank Ltd (No 2)* (1997) 15 ACLC 248).

Capital Reduction

A takeover can also be effected by a reduction of capital. Since 1 July 1998, it has not been necessary to obtain court approval for a reduction of capital.

A takeover by reduction of capital usually involves the "bidder" acquiring shares in the target company and the remaining shares being cancelled either for cash from the target company or for some consideration (which might include shares) emanating from the bidder. If the consideration involves scrip issued by a third party, a scheme of arrangement will be required (in addition to the reduction of capital) in order to compel members to accept those shares.[14]

Section 256B of the *Corporations Act* provides that a company may reduce its capital if the reduction:

- is fair and reasonable to the company's shareholders as a whole;
- does not materially prejudice the company's ability to pay its creditors; and
- is approved by shareholders in accordance with the *Corporations Act*.

The cancellation of shares will normally involve a selective reduction of capital. Section 256C requires that this is approved by either:

> "(a) a special resolution passed at a general meeting of the company, with no votes being cast in favour of the resolution by any person who is to receive consideration as part of the reduction ...; or
> (b) a resolution agreed to, at a general meeting, by all ordinary shareholders."

In addition, a special resolution must be passed at a meeting of shareholders whose shares are to be cancelled.

In a company with numerous shareholders, it would not be feasible for a resolution to be agreed to at a general meeting by all ordinary shareholders. (The reference to "all ordinary shareholders" requires not only that the resolution passed at the meeting be unanimous, but that it be agreed to by *every* ordinary shareholder in the company.) Accordingly, in order to effect a selective capital reduction, it is generally necessary for two special resolutions to be passed. The first is a special resolution at a general meeting of the company, with no votes cast in favour of the resolution by any person who is to receive consideration as part of the reduction. The

[14] *Re Hunter Resources Ltd* (1992) 10 ACLC 538.

second special resolution needs to be passed by shareholders whose shares are to be cancelled.

The mechanism in s 256C(2)(a) has been described as "cumbersome"[15] and there is an unfortunate lack of clarity in the drafting of the provision. The requirement that no votes be cast in favour of the resolution by a person who is to receive consideration means that although recipients of the consideration cannot vote in favour of the resolution, they can vote against it, giving them disproportionate voting power. The Explanatory Memorandum which accompanied the Company Law Review Bill 1997[16] stated that the first special resolution was intended to reflect the wishes of the company's "disinterested shareholders". This suggests that shareholders who will receive consideration should not be able to vote either for or against the first resolution. Unfortunately, the legislation only prevents such shareholders voting in favour of the resolution, and does not prevent them voting against it.

There is uncertainty as to which shareholders should be regarded as receiving consideration "as part of the reduction". Some of the possibilities were considered in *Re Tiger Investment Company Ltd*.[17] That case involved an existing controlling shareholder, Metals Explorations Limited (MetalsEx), becoming the sole shareholder in Tiger Investment Company Limited (Tiger) as a result of cancellation of the minority Tiger shareholdings (with no money being paid by Tiger), in consideration of the issue of shares in MetalsEx to the former Tiger shareholders, pursuant to an interdependent scheme of arrangement between Tiger and the minority shareholders. There was concern as to whether the Tiger shareholders could vote on the first resolution, because the Tiger shareholders were receiving consideration from MetalsEx pursuant to the scheme of arrangement, even though they received no consideration directly from Tiger. Santow J thought there was merit in the argument that where the consideration moves from a third party, none of the company's shareholders is prevented from voting on the first resolution because the reduction does not involve liberation of the company's assets.

There was also a concern that MetalsEx itself might not be permitted to vote in favour of the first resolution, on the basis that it could be regarded as receiving consideration "as part of the reduction" (on the basis that it would benefit from becoming the sole shareholder in Tiger). The counter argument (which it is submitted is correct) is that the commercial benefit to be derived from MetalsEx becoming the sole shareholder in Tiger was a *consequence* of the

[15] *Re Tiger Investment Co Ltd* (2000) 18 ACLC 62 at 67.
[16] Paragraph 12.17.
[17] *Re Tiger Investment Co Ltd* (2000) 18 ACLC 62.

cancellation of shares taking effect but did not involve MetalsEx receiving consideration "as part of the reduction".

These uncertainties led to Tiger putting the first resolution twice to a general meeting. The first time the resolution was put, MetalsEx did not vote (which dealt with the possibility that it might be regarded as receiving consideration under reduction). The second time the resolution was put, minority Tiger shareholders were informed that although they could vote against the resolution, any vote in favour by them would not be counted. This was intended to address the possibility that the minority shareholders might be regarded as receiving consideration under the reduction.

In addition to taking these steps, Tiger also amended its constitution on the day before the special resolutions were to be passed, for the purpose of authorising the company not to count any vote which may have been "cast" by a person who was to receive consideration under s 256C(2)(a).

Although it may not always be necessary for an "acquirer" to resort to these steps to effect a takeover by way of selective capital reduction, the awkward drafting of s 256C(2)(a) does reduce the attractiveness of the selective capital reduction route in a number of fact situations.

The capital reduction provisions also provide some scope for minority shareholder activity. As mentioned above, a company may reduce its capital if the reduction is fair and reasonable to the company's shareholders as a whole and does not materially prejudice the company's ability to pay its creditors. Section 1324(1B)(a), which relates to injunctive relief, contemplates that a selective reduction of capital may be challenged in court on grounds including a lack of fairness and reasonableness or material prejudice to creditors. Further, s 1324(1B) reverses the onus of proof by providing that the court must assume that conduct constitutes, or will constitute, a contravention of s 256B(1)(a) or (b) unless the company proves otherwise.[18]

Dual Listed Companies

Another transaction structure which has achieved prominence recently is the dual listed companies (DLC) structure. In essence, a DLC structure involves two separately listed companies, each with their own shares (separately listed and traded) and shareholders, agreeing to be combined by various mechanisms to operate as

[18] See *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2000) 18 ACLC 665.

though one economic entity. The first DLC in Australia involved CRA and RTZ in 1995. There have been no Australian DLC's since then until 2001 when BHP and Billiton shareholders approved a DLC in May 2001, which took effect on 29 June 2001. A DLC between Brambles and a division of GKN has also been approved by shareholders in both companies. Each of these DLC's involve an Australian company and a United Kingdom company.

Two other examples of DLC's are Unilever NV/Unilever PLC and Royal Dutch Petroleum Company/the Shell Transport and Trading Company PLC. Each of these latter two DLC's involves one company incorporated in the United Kingdom and one company incorporated in the Netherlands.

The Shell structure differs from the others in that that the group assets are consolidated to a greater extent through two group holding companies, each of which is held 60:40 by the Netherlands and United Kingdom listed companies. In effect, this is more in the nature of an incorporated joint venture with two listed holding companies.

Under the BHP/Billiton model, broadly speaking, the listed "parent" companies own different assets, but are unified to operate as though they were one entity through a number of measures, including:

- identical boards of directors;
- joint voting by shareholders of both companies on certain major issues (such as appointment and removal of directors, adoption of accounts, creation of new classes of shares, major acquisitions and disposals);
- joint voting is achieved by the votes cast at the meeting of each company being reflected at the meeting of the other. This is done by means of a "special voting share" issued by each of the companies, which is voted by a public trustee company to cast the appropriate number of votes (determined in accordance with the "equalisation ratio") in the same proportions (for and against) as the votes cast at the meeting of the other company;
- arrangements to ensure that dividends (and any other distributions) paid by each company are equivalent (that is, made in proportion to the equalisation ratio); and
- reciprocal guarantees by each company in favour of the creditors of the other company.

Creation of a DLC structure is likely to require:

- substantial amendment of the constitutions of the relevant companies;

- the issue of bonus shares to achieve the appropriate ratio of economic interests between shareholders of the relevant companies;
- the creation and issue by both companies of “special voting shares” (as mentioned above) to trustee companies;
- the relevant companies entering into a range of contractual arrangements (including an implementation agreement, a sharing agreement, and reciprocal guarantees).

Creation of a DLC would normally involve changes to the relevant companies’ constitutions (which for an Australian incorporated company would require a special resolution passed by least 75 percent of votes cast at a general meeting). It is also likely to need modification of the Australian takeover laws by ASIC. Shareholder and regulatory approval may also be required in the jurisdiction of incorporation of the other company in the DLC.

It is interesting to note that there are no DLC’s involving Australian and United States corporations. This may be for taxation reasons, as well as difficulties in harmonising the Australian/United States company laws.

Advantages of a DLC structure include:

- the procedure for implementation may be simpler than either a scheme of arrangement or takeover bid. As mentioned above, a special resolution(s) of members of the component companies may be all that is required (in addition to any necessary modifications or approvals being granted by regulators);
- there are no taxation implications for existing shareholders in the component companies of a DLC – as the shareholders are not acquiring or disposing of any shares, their position remains unchanged;
- the “acquiring” company not being exposed to the risk that a shareholder in the target company will receive foreign scrip which it is not able, or does not wish, to hold and which must then be realised (resulting in a sell off of shares in the acquiring company and pressure on its share price – the “flow back” issue);
- as an on-going matter, investors can decide whether they would prefer to own shares (and receive dividend income) from a company incorporated in one jurisdiction or the other. In the case of the shareholders in an Australian company, they can continue to receive franked dividends under our dividend imputation system;
- improved access by the DLC to capital markets;

- the DLC has a choice of jurisdictions in which to effect future acquisitions – it can use one or other of the component companies in the DLC as the acquiring vehicle. This can be efficient in terms of tax and transaction costs;
- importantly, in the case of mining companies which are often participants in joint ventures having change of control provisions, a DLC may not trigger a change of control provision (but a takeover bid may trigger such provisions). Most change of control provisions focus on a company becoming a subsidiary of another company. A DLC does not result in one company becoming a subsidiary of another and the issue of a special voting share would not normally trigger change of control provisions. With the advent of DLC's, however, it is noticeable that change of control provisions in joint venture and other documents are being more wiedely drafted to encompass any transaction which has an economic effect similar to a takeover, or which involves the target company being run as a single economic entity with another company,
- the possibility of adopting a more favourable accounting treatment which results in higher post-merger profits being available for distribution. At present, the Australian Accounting Standards require a purchase method of accounting to be used for an acquisition of an entity.[19] This involves recognising the difference between the fair value of the net assets acquired and the purchase consideration as goodwill. That goodwill must be amortised over a period not exceeding 20 years, resulting in lower profits being available for distribution by way of dividend. The view may be taken, however, that a DLC involving two companies of roughly equal size does not involve an "acquisition" and therefore that the purchase method of accounting need not be applied.

OTHER DEVELOPMENTS – BREAK FEES AND "NO SHOP" AGREEMENTS

Break fee and no shop agreements have been the subject of considerable attention by Australian merger and acquisition (M&A) lawyers (and investment bankers) in the last year.

A "break fee" is a fee which a party to a transaction (which may include a takeover, scheme of arrangement, DLC or other combination) agrees to pay if a specified event occurs which prevents the transaction being completed. Trigger events which could cause the fee to be paid include a counter bidder acquiring a

[19] See AASB 1015 and 1024.

specified majority of shares in the target (for example, 50 percent or 90 percent) or the target company directors taking action which causes the transaction to fail (for example, by recommending a rival takeover bid or, in the case of a scheme of arrangement, recommending that shareholders vote against the scheme).

A "no shop" agreement requires the target not to solicit offers from a third party, usually for a defined period. The agreement may also require the target not to negotiate with a third party, even if the third party's approach is not solicited.

Although break fee and no shop arrangements are different in nature, they share some "lock-up" characteristics. Such devices are common in the UK and US. Until the last year they were relatively rare in Australia (at least in the case of break fees in a takeover bid).

In the UK, the City Code on Takeovers and Mergers permits payment of an "inducement fee" provided it is de minimus (normally not more than 1 percent of the bid value). There is an additional requirement that the target company and its financial adviser confirm to the Panel in writing that they believe the fee to be in the best interests of shareholders.[20] In the US, break fees are also common, but the amount of the fees may be significantly larger (sometimes up to 5 percent of bid value).

There have been a number of examples of resources companies entering into break free agreements in the last year. In mid 2000, North was subject to a takeover bid from Rio Tinto at a price North considered inadequate. North agreed to reimburse a potential counter bidder, Anglo American, for its reasonable expenses up to a cap of 5 cents per share (roughly 1 percent) of bid value to induce it to make a counter bid. The triggers for payment of the break fee were another bidder acquiring more than 50 percent of shares in North at a price higher than Anglo American's proposed price or the North directors failing to recommend Anglo American's bid.

Shortly afterwards, Ashton Mining was the subject of a takeover bid by De Beers. De Beers had a pre-bid agreement with a major shareholder which entitled it to acquire 19.9 percent of the shares in Ashton Mining at its bid price. De Beers was then overbid by Rio Tinto. De Beers could have chosen to abandon its bid at that point, but still make a profit by selling its 19.9 percent interest to Rio Tinto at Rio Tinto's higher offer price. To induce De Beers to increase its offer (which would have automatically increased the amount payable by De Beers to the major shareholder for the 19.9 percent holding), Ashton Mining agreed to reimburse De Beers for its expenses plus profit foregone. The reimbursement was capped at 2 cents per share

[20] City Code on Takeovers and Mergers, r 21.2.

(less than 1 percent of the offer consideration). The trigger events for payment were similar to the North/Anglo American agreement.

In March 2001, BHP and Billiton entered into an implementation agreement for their DLC which provided for payment of a break fee of US$100 million by way of liquidated damages. The arrangement was mutual and one party was required to pay the fee to the other if the first party's shareholders did not approve the transaction or its board changed its recommendation.

There have been a number of other instances of break fees in both the resources and non-resources contexts. Possibly, the emergence of such arrangements reflects the commercial requirements of foreign acquirers. More likely, it reflects the increased involvement of foreign investment banks and introduction of international M&A practices into Australian transactions.

Break Fees

Because of the relatively recent emergence of break fee arrangements in Australia, there has been very little judicial consideration of them. Some of the legal issues which may be relevant are summarised below.

- Does agreement to pay the fee involve financially assisting an acquisition of shares in a prohibited manner?

  Section 260A of the *Corporations Act* provides that:

  > "A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if:
  >
  > (a) giving the assistance does not financially prejudice:
  >
  > (i) the interests of the company or it shareholders; or
  >
  > (ii) the company's ability to pay its creditors ..."

  There is some argument as to whether this section prohibits payment of a fee to an unsuccessful bidder (that is in circumstances where there has not in fact been an acquisition of shares). It is worth noting that the predecessor of s 260A(1), s 205(1) of the *Corporations Law*, prohibited the giving of financial assistance in connection with a "proposed acquisition" of shares. Although s 260A(2)(a) provides that financial assistance may be given before or after the acquisition of shares, s 260A still appears to contemplate that there will be an "acquisition" of shares. Arguably, s 260A is narrower than its predecessor.

It should also be noted that s 260A(1)(a)(i) distinguishes between the interests of the "company" and its "shareholders". Presumably, directors of the target would not agree to pay a break fee if it would be contrary to the interests of the company (see below). If payment of a break fee might deter a counter bidder, it could be argued that this prejudices the interests of "shareholders". It might be argued that payment of the fee also prejudices shareholders who wish to retain their shares in the company. The issue is whether any prejudice is "material".

- Is there a breach of director's duties?

  Directors must exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose (s 181). Matters which the directors of a target might take into account in deciding whether to agree to a request for a break fee include the terms of the proposed bid/scheme of arrangement (including price, prospects of success – which might include an assessment of any conditions), the prospects of a higher offer being made, the trigger events which render the break fee payable and, importantly, the size of the break fee.

  There is an issue that directors owe a duty to the company, as distinct from individual shareholders. Although the interests of the "company" may be regarded as indistinguishable from the interests of its current shareholders in a takeover situation, it is desirable that the break fee be regarded as benefiting the company in some corporate sense (for example, by paying a fee and facilitating a takeover, the business of the company will be enhanced).

- Would payment of the fee oppress the minority?

  A break fee might be challenged under s 232 of the *Corporations Act* on the basis that it is either contrary to the interests of the members as a whole or oppressive to, or unfairly prejudicial to, or unfairly discriminatory against, a member or members (whether in that capacity or another capacity) (s 232(d) and (e)). A minority shareholder might argue, for example, that payment of a break fee in circumstances where a competing bidder acquires less than 100 percent of a company (or does not achieve the compulsory acquisition threshold of 90 percent) is unfairly prejudicial to minority shareholders who wish to retain their shares in the target company (since the target company's assets will be diminished by payment of the break fee).

In addition, it is possible that the Takeovers Panel might declare that a break fee agreement constitutes "unacceptable circumstances", in light of the provisions of ss 602 and 657A of the *Corporations Act* (particularly the objective of an "efficient, competitive and informed

market" in s 602(a)). In a draft policy released on 2 August 2001,[21] the Panel has indicated that it does not regard break fee arrangements (or no shop agreements) as prima facie unacceptable. The Panel has indicated that in general it will not declare a break fee agreement to be unacceptable if it permits the bidder to recover its reasonable outgoings and internal costs. In some circumstances, it may be reasonable for the arrangement to extend to the reasonable opportunity costs of the bidder. The Panel has also indicated that it is good practice for the fee to be subject to a cap and has adopted the London City Code cap of 1 percent as a "guide". The Panel has indicated that each case will depend on its circumstances and that a 1 percent cap may be too low in the case of small bids, but unacceptably high in the case of large bids.

No Shop Agreements

Exclusivity arrangements are quite common in merger arrangements. As Santow J eloquently put it in *Re Arthur Yates & Co Ltd*: "these constraints recognise the commercial reality that a prospective bidder under scheme or takeover would not wish to spend substantial time and money on a bid proposal only to find that the directors of the target have used that bid as a stalking horse for a better one."[22] The *Yates* case involved a scheme of arrangement under which Arthur Yates & Co Limited merged with another company. At the first court hearing to order the scheme meetings, Santow J gave the following guidance on exclusivity arrangements:

- they should be for no more than a reasonable period capable of a precise ascertainment;
- while an exclusivity clause may differentiate between actively soliciting an alternative merger proposal or simply dealing with an unsolicited one, in either case, it is important that the exclusivity arrangement be framed so that it is subject to the overriding obligation not to breach the directors' fiduciary duties or otherwise be unlawful; and
- there should be adequate prominence given to the restraint in the explanatory materials sent to shareholders.

In its draft policy on lock-up devices, the Takeovers Panel has indicated that it will have regard to these kinds of factors in determining whether a no shop agreement is anti-competitive and constitutes "unacceptable circumstances". In addition, the Panel has identified another factor, being whether directors of the target company have tested the market for possible rival bidders before entry into the

[21] Corporations and Securities Panel draft "Policy on Lock-up Devices", August 2001.
[22] *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758 at 760.

exclusivity arrangements. The Panel also indicated that an exclusivity arrangement which continues after a bid has been announced is more likely to be anti-competitive and, hence, unacceptable.

The operation of a "no shop" clause in the context of a due diligence request, was considered by the Court of Appeal in New Zealand in connection with the Shell/Apache acquisition of Fletcher Challenge Energy.[23] The implementation agreement prohibited Fletcher Challenge soliciting offers from a third party, but contained a carve out for the directors of Fletcher Challenge to comply with their fiduciary duties.

It was proposed that the acquisition would be effected under a scheme of arrangement between Fletcher Challenge and its shareholders. After the court had ordered the relevant shareholders meeting be convened, but before it had actually been held, another company (Greymouth Petroleum Mining Company Limited) requested an opportunity to conduct due diligence. The Court of Appeal in New Zealand held that the "no shop" clause did not prevent Fletcher Challenge from allowing Greymouth to conduct due diligence in the circumstances where Fletcher Challenge had not solicited the bid. Further, the directors' duties carve out would have permitted the directors of Fletcher Challenge to allow due diligence, if they believed it was in the company's best interests.

The effect of these decisions is that a "no shop" agreement may be no more than a statement of good faith at the time it is entered into, but may not preclude the target talking to or, indeed, facilitating, a counter bid if that would be in the target company's best interests.

CONCLUSION

Takeovers are driven by whether it makes commercial sense to merge two companies or not. A number of the developments above have facilitated mergers occurring where that is the case. In particular, the rejuvenation of the Takeovers Panel, as the arbiter on disputes concerning takeovers, has given the market, and bidders, confidence that the outcome of a bid will be determined on its commercial merits by target company shareholders, rather than tactical litigation in the courts. The flexibility of regulators, such as ASIC, to permit mergers to occur, other than through a formal takeover bid (and provided certain safeguards are met), has also enabled some mergers to be structured in a manner which best meets the parties' commercial objectives.

[23] *Greymouth Petroleum Mining Company Ltd v Fletcher Challenge Ltd & Ors* (unreported, 6 March 2001).

return to AMPLA 2001 Table of Contents