

# REGULATION OF CORPORATE CONTROL IN AUSTRALIA: A HISTORICAL PERSPECTIVE

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## ABSTRACT

As the process of financial and economic reform gains pace throughout the Asia-Pacific region, one important aspect that deserves the attention of business and legal analysts is the regulation of corporate control. The purpose of this paper is to describe and assess the evolution of corporate control regulation in Australia. With some important changes to takeover law about to be passed by parliament, it is appropriate and timely to reflect on the process of regulatory change that has given us our current system, so that lawmakers may avoid the errors and pitfalls of the past. This assessment of the process of regulatory change in Australia may also provide lessons for regulators in the Asia-Pacific region.

The current takeover legislation in Australia is the result of a series of overhauls and amendments since the introduction of the first national legislation in the Uniform Companies Act 1961. In 1971 there were considerable amendments to the legislation as a result of the recommendations of the Eggleston Committee's review of company law. In the late 1970's, a major review led to the passing of new legislation which became the Companies (Acquisitions of Shares) Act 1981 (CASA). With very few changes the provisions of CASA were encapsulated in Chapter 6 of the Corporations Law, which currently applies.

The process of regulatory change in relation to corporate control has been characterised by legislative amendments in reaction to anecdotal evidence and perceived changes in public opinion, and as a result of political compromise. It has also been characterised by an absence of attention to quality empirical evidence regarding the benefits of takeovers, and the economic effects of regulation. We now have a rather cumbersome system of takeover regulation which has two main problematic features. *First*, it is a hybrid of two systems of regulation: 'black-letter law', and a self-regulatory approach embodied in the Corporations and Securities Panel, overseen by the Australian Securities Commission (ASC). The issue of method of regulation - whether it should be by means of 'black-letter law' or self-regulation as exemplified by the British approach - has been a feature of the debate for almost thirty years. *Second*, there is considerable skewness in the regulations toward protection and equality of treatment of target shareholders. Fairness to target shareholders has been a common theme in the debate, and has directed much of the legislation.

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## I. INTRODUCTION

With some important reforms to takeover regulation about to be introduced as part of the Australian government's Corporate Law Economic Reform Program (CLERP),<sup>1</sup> it is timely to reflect on the history of Australia's regulation of corporate control. In assessing the need for reform, it is important not only to evaluate the current system of regulation, but also to understand the process of regulatory change that has given us that system. The current takeover legislation is the result of a series of overhauls and amendments since the introduction of the first national legislation in the Uniform Companies Act 1961 (UCA). In 1971 there were considerable amendments to this legislation as a result of the recommendations of the Eggleston committee's review of company law.<sup>2</sup> In the late 1970's, a major review led to the passing of new and very detailed legislation which became the Companies (Acquisitions of Shares) Act 1981 (CASA). CASA included provisions allowing the discretionary powers of the newly-formed 'corporate watchdog', the National Companies and Securities Commission (NCSC). In the mid-1980's there were a few significant and controversial amendments to CASA. With little change the provisions of CASA were encapsulated in Chapter 6 of the Corporations Law (1990), which currently applies.

We now have a rather cumbersome system of takeover regulation which has two main problematic features. *First*, it is a hybrid of two systems of regulation: a 'black-letter law' approach, and the limited discretionary powers of the Corporations and Securities Panel (the Panel), overseen by the Australian Securities Commission (ASC). This has resulted from a 30-year debate over the best method of regulation for corporate control - whether it should be by means of 'black-letter law,' or self-regulation as exemplified by the British approach. *Second*, there is considerable skewness in the regulations toward protection and equality of treatment of target shareholders. Fairness to target shareholders has been a common theme in the debate, and has directed much of the legislation. Further, while the legislation imposes considerable controls and requirements on the management of the bidding firm, there are few formal controls on the behaviour of target management. Control of defensive actions of target management is largely left to the courts.<sup>3</sup>

There are two important amendments proposed in the CLERP which go some way to addressing the problems that result from these features. The first is a much enlarged role for the Corporations and Securities Panel, which it is hoped will take the place of the courts in dispute resolution. The second is the so-called 'follow-on' or mandatory bid rule, which will allow the acquisition of a shareholding greater than the current 20 percent takeover threshold, as long as an immediate bid for all remaining shares follows.<sup>4</sup>

1 The Corporate Law Economic Reform Program (CLERP) discussion paper no. 4 "Takeovers" was released on 11<sup>th</sup> November 1997. The Company Law Review Bill 1977, containing amendments to takeovers law, was passed by the House of Representatives on 4<sup>th</sup> March 1998. It is expected to be passed by the Senate in the 1998 Winter Sitting.

2 The Company Law Advisory Committee Report to the Standing Committee of Attorneys General on Disclosure of Substantial Shareholdings and Takeovers, 1969.

3 This issue is not discussed in this paper; it has been addressed recently by two excellent articles: N Rogers, "When Can Target Directors Legitimately Frustrate a Takeover Bid?" (1994) 12(4), *Company and Securities Law Journal* 207 and also J Farrer, "Reforming Australia's Takeover Defence Laws: What Role for Target Directors?" (1997) 8 *Australian Journal of Corporate Law* 1.

4 CLERP, *supra*, n 1.

## 1.2 The Process of Takeover Regulation

The process of regulatory change in relation to corporate control has been characterised by legislative amendments in reaction to anecdotal evidence and perceived changes in public opinion, and as a result of political compromise. It has also been characterised by an absence of attention to quality empirical evidence on the benefits of takeovers and the economic effects of regulation.

It is well recognised in the regulation literature that the most common impetus for regulatory change is political reaction to popular opinion. If a particular issue in which certain groups or individuals are seen as disadvantaged becomes 'hot' and is picked up by the media, there are often accompanying calls for increased regulation. In such a situation, it is rational for politicians to want to assuage public concerns:

"Politicians or bureaucrats, in devising a regulatory instrument, may gain prestige, and therefore satisfaction, from being seen to respond swiftly and positively to problems that suddenly receive prominent media attention - perhaps as a result of some crisis or disaster."<sup>5</sup>

The process of takeover regulation is no exception: the forces for change have been largely political. This appears to have been the case in Australia as well as in New Zealand,<sup>6</sup> in the UK<sup>7</sup> and the US.<sup>8</sup> An examination of the history of corporate control regulation in Australia reveals that at times this pattern has been particularly exaggerated, with changes being made which have had more far-reaching effects than the correction of the original 'loophole.'

So why have political forces been the dominant catalyst for change in Australia's takeover regulation? One reason is that there is considerable public interest in corporate takeovers. There is a huge quantity of money at stake. Between 1972 and 1985, there were over 1300 takeover bids launched on companies whose average size was \$5.3 million.<sup>9</sup> Average takeover premiums (that is, the excess paid by bidders over and above the pre-bid share price) ranged from a low of 31 percent in 1982 to a high of 69 percent in 1977,<sup>10</sup> resulting in an estimated \$7.2 billion of wealth creation.<sup>11</sup>

A second reason is that there are many interested players in takeover contests, all with different, strongly self-interested perspectives.<sup>12</sup> Because of the widespread interest in takeovers, and public ignorance of the purposes and workings of capital markets, it is not difficult for interested individuals to push their interests through the media. This is particularly so if public ignorance is shared by the financial journalists:

5 A Ogus, *Regulation: Legal Form and Economic Theory* Clarendon Press, Oxford, 1994, p 75.

6 B Wilkinson and A. Mandelbaum "The Takeover Debate in the Context of Securities Regulation in New Zealand: A Law and Economics Perspective" in *Securities Regulation in Australia and New Zealand*, eds G Walker and B Fisse, Oxford University Press 1994.

7 J Winsen "Regulation of Trading in Corporate Equity: Constraints on Takeovers" (1982) 1 *Company and Securities Law Journal* 91.

8 G Jarrell, A Poulsen and J Pound "Regulating Hostile Takeover Activity: An Interpretative History of the US Experience" in *Takeovers and Corporate Control: Towards a New Regulatory Environment* Centre for Independent Studies, 1987, p 17.

9 S Bishop, P Dodd and R Officer *Australian Takeovers: The Evidence 1972-1985* The Centre for Independent Studies Ltd., Policy Monographs Series, 1987 p 22.

10 *Ibid*, p 27.

11 *Ibid*, p 45.

12 Wilkinson and Mandelbaum, *supra*, n 6, p 783-784. The authors provide a long list of interested parties and their likely wants.

“The competence of the media assumes such importance because of the general inability of even those who do attempt to formulate their own assessment of the issues, and who may be highly trained in other fields, to appreciate the subtleties of financial markets - there is even no basis for necessarily concluding that all those involved in takeovers, on any side, appreciate the wider consequences of the activity in which they are involved. Indeed, it is likely that many journalists take a particular view because of discussion with, and analysis of statements of, those who appear to be in a position to comment meaningfully. Of course, there are exceptions to the general thrust of this scenario, but it is perhaps unfortunate that in the heat of a takeover battle it is often only those with a particular ‘axe to grind’ who are willing (indeed demand) to talk to the media.”<sup>13</sup>

Many commentators, have, over the years, advocated a more systematic approach to reform of takeover regulation. The most common call has been for more attention to be paid to quality empirical research regarding the effects of regulation on takeover activity, and the likely economic impacts of proposed changes in the regulations.<sup>14</sup> These have been largely ignored by lawmakers and politicians.

Section 2 presents a brief history of national corporate control legislation in Australia. Section 3 - ‘black-letter law versus self-regulation’ - is a history of the ‘method of regulation’ debate. Section 4 examines the question of skewness in the regulation toward the protection of target shareholders. To illustrate this issue a history of the partial bid debate is presented. The final section summarises the paper and draws together the conclusions.

## II. A BRIEF HISTORY

The first national takeover legislation was section 184 of the Uniform Companies Act (1961). It occupied only two pages of that statute.<sup>15</sup> It drew largely on the rules which were in place for listed companies by the Associated Stock Exchanges,<sup>16</sup> and the regulations in force in the U.K.<sup>17</sup> The legislation covered four general areas: (1) the provision of sufficient information to interested parties to make an informed appraisal, (2) the prevention of target management from receiving special benefits, (3) the prevention of the oppression of both minority and majority shareholders, and (4) “to ensure, where possible, that the takeover transaction does not offend against what should be regarded as a fair business deal.”<sup>18</sup> Compared to the current legislation, the requirements of section 184 were very basic. It is therefore interesting that one commentator wrote:

“The requirements of this act..... are onerous but are in conformity with the trend of company legislation which has always been to demand the disclosure by the company of more and more information of its activities”<sup>19</sup>

13 Winsen, *supra*, n 7, at 102-103.

14 See R Baxt, “The Takeover “Mania” (1986) 4(3) *Company and Securities Law Journal* 145 at 147; P Dodd, “Corporate Control: What are the Issues?” in *Takeovers and Corporate Control: Towards a New Regulatory Environment* Centre for Independent Studies, 1987, p 3; and I Ramsey, “Balancing Law and Economics: the Case of Partial Takeovers” 1992 *July Journal of Business Law* 369.

15 Baxt, *supra*, n 14, at 145.

16 H A J Ford (1962) “Uniform Companies Legislation” 1962 5(2) *University of Queensland Law Journal* 133 at 153.

17 R Parsons, “Uniform Company Law in Australia” 1962 July, *Journal of Business Law*. 235 at 242.

18 B Shtein, “Some Legal Aspects of Company Takeovers in Australia” 1965 5(1) *University of Queensland Law Journal* 47 at 48.

19 *Ibid*, at 51.

By the end of the 1960's, the legislation had come under considerable criticism for having several loopholes. The provisions of the legislation applied to corporations but not to individuals. The one-third threshold - the level of shareholding beyond which the provisions of section 184 applied - was considered to be too high. Many commentators advocated the lowering of this threshold, because control of a company could be gained at a lower level, particularly those with dispersed shareholdings.<sup>20</sup>

Probably the more controversial aspect of the legislation was its neglect to provide equality of opportunity for target shareholders. The provisions of section 184 did not apply when the 'offer' came from the shareholders of the target company. This allowed what became known as the 'first-come first-served' takeover bid, which was when "a bidder or its broker would write to shareholders suggesting the bidder's interest but making no firm offer to buy. Instead, the bidder said that offers to sell would be accepted in the order in which they were received."<sup>21</sup> This created a situation where some target shareholders missed out on the premium offered by bidders; but they had other features which were seen as 'undesirable':

"In such bids the identity of the bidder is not disclosed, the views of directors are not sought, there is pressure for a quick decision and generally there is inequality of treatment of shareholders. All of these features are undesirable."<sup>22</sup>

In more colourful language, another commentator wrote:

"It is felt that the great deficiency of the legislation is the element whereby certain types of shareholders, i.e., 'widows and orphans' etc., are completely at the mercy of the 'fast buck' operator and can expect nothing from them."<sup>23</sup>

Another feature of section 184 that was seen as inequitable was that target shareholders could be paid differentially for their shares. If the bidder increased the price offered, shareholders who had accepted earlier would receive a lower price.<sup>24</sup>

In 1971 there were some major amendments to takeover law with the passing of The Companies (Amendment) Act, 1971, which became effective on the 1<sup>st</sup> January, 1972.<sup>25</sup> These amendments were passed as a result of the recommendations of the Eggleston committee. The Eggleston report enunciated four principles which were to guide takeover regulation. It is worth quoting these in full because they have become the most important philosophical guide to takeover legislation in Australia, having become enshrined in CASA (sections 59 and 60), and are now encapsulated in Chapter 6 of the Corporations Law (sections 731 and 732).

"We agree with the general principle that if a natural person or corporation wishes to acquire control of a company by making a general offer to acquire all the shares, or a proportion sufficient to enable him to exercise voting control, limitations should be placed on his freedom of action so far as is necessary to ensure:

- (i) that his identity is known to the shareholders and directors;
- (ii) that the shareholders and directors have a reasonable time in which to consider the proposal;

20 Ibid, at 56; also J Bishop "Takeovers: Mechanics and Pitfalls" 1970 22(3) *The Chartered Secretary* 131at 133.

21 H A J Ford, *Principles of Company Law*, Second Edition, Butterworths 1978, p 459.

22 N Savage, "A Critical Look at Company Takeovers" (1969) 21 *The Chartered Secretary* 145 at 149.

23 Bishop, *supra*, n 20, at 133.

24 Shtein, *supra*, n 18, at 56.

25 D Block, "Does the New Takeover Legislation Achieve its Objective?" (1973) 1(3) *Business Law Review* 236.-

- (iii) that the offeror is required to give such information as is necessary to enable the shareholders to form a judgement on the merits of the proposal and, in particular, where the offeror offers shares or interests in a corporation, that the kind of information which would ordinarily be provided in a prospectus is furnished to the offeree shareholders;
- (iv) that so far as practicable, each shareholder should have an equal opportunity to participate in the benefits offered.”<sup>26</sup>

The Eggleston amendments included the requirement that the legislation apply to individuals as well as corporations, and the lowering of the takeover threshold from one-third to 15 per cent. The offer had to be made to all target shareholders, and if the bidder increased the offer, all target shareholders had to be paid the same price even if they had accepted at a lower price.

As well as formal takeover bids, the legislation allowed two other methods of takeover. It allowed the unregulated acquisition of a controlling interest in listed companies in ordinary trading on the stock exchange. It also allowed, beyond the 15 per cent threshold, up to four individual offers for unlimited quantities of shares within four months. These provisions were directed by the Eggleston recommendations: “The committee recommended ‘...that an offeror should be free to approach a limited number of shareholders in pursuance of a plan or purpose without having to go through the [takeover] procedure...’ The committee also recommended that shares acquired ‘in the normal course of trading on a stock exchange’ should be exempted from takeover regulation.”<sup>27</sup>

These provisions - allowing two methods of unregulated takeovers - were subject to considerable criticism in the 1970’s. They were seen as inequitable, because, in contrast to a formal bid, the offer did not have to be made to all shareholders.<sup>28</sup> There were other sources of controversy during the 1970’s. Partial takeover bids were seen as highly inequitable, as many target shareholders did not have the opportunity to participate in the control premium.<sup>29</sup> Some takeovers were conducted through front companies, with the principals behind the takeover remaining unknown. Again, both of these apparent ‘loopholes’ in the legislation resulted from recommendations of the Eggleston committee.<sup>30</sup>

In the late 70’s the State Attorneys General met to discuss changes to takeover legislation, which they considered to be seriously deficient. The story of the negotiations leading to CASA - extending over several years - illustrates the fact that political forces tend to drive the process of regulatory change. However, the federal system with state-based powers made the task of reforming Australia’s takeover laws particularly difficult. Agreement had to be reached between the federal government and the governments of seven states.

In February 1978 the Ministerial Council, comprising state Attorneys General and the federal Minister for Business and Consumer Affairs, sought submissions from interested parties on a review of the takeover legislation. A draft Bill, which was based on the U.K. regulations,<sup>31</sup> was drawn up and

26 R. Eggleston “Proposed Amendments to the Uniform Companies Acts” (1969) 21(1) *The Chartered Secretary* 59 at 61.

27 Winsen, *supra*, n 7, at 98.

28 On-market bids became known as ‘market raids’; see Australian Financial Review 17/1/79 “how to drive a horse and cart through the new takeover code” 24 and 27, at 24.

29 The partial bid is discussed in detail in section 4.3.

30 Eggleston, *supra*, n 26, at 60-61.

31 Australian Financial Review, *supra*, n 28, at 24.

released for public comment in December. The Ministerial Council had difficulty in reaching agreement on the contents of this first draft bill, and it was circulated for public comment “so that certain disagreements might be clarified...”<sup>32</sup>

This exposure draft was widely criticised, mainly on the grounds of excessive legalism. As a result the Attorneys General agreed to some simplifications and amendments to the Bill. The most important change was the inclusion of the discretionary powers of the NCSC.<sup>33</sup> By November 1979 they had agreement, and the amended Company Takeovers Bill 1979 was introduced into parliament. In drafting this second version of the bill, the Ministerial Council again had trouble reaching a consensus on its contents. It was reported that

there is quite a strong hope among some of the people associated with the lengthy process of getting uniform takeover legislation this far that Saturday’s meeting will give the go-ahead...there is a feeling that the delays over the past year - due mainly to political infighting over the siting of the NCSC head-quarters and widespread criticism of the major exposure draft bill issued last December - will result in the bill being outdated by the time it becomes law...broadly (those responsible for its drafting) say the flexibility built into the draft bill to go to Saturday’s meeting could be the legislation’s saving grace, by making it acceptable to the securities industry.<sup>34</sup>

In early 1980, the public was again invited to comment on the bill. In order to accommodate further changes to the prospective legislation, the Company Takeovers Bill was withdrawn and in April 1980 a new Bill, the Companies (Acquisitions of Shares) Bill, was subsequently enacted.<sup>35</sup>

CASA was a very long and detailed piece of legislation, stretching over 100 pages.<sup>36</sup> The acquisition of greater than 20 percent of the voting shares in a company was prohibited, except via the mechanisms specified in the Act. A takeover could be effected in three ways: the ‘Part A’ bid, (or takeover scheme); the Part C bid (or takeover announcement); or the ‘creeping takeover.’ The Part A bid became the most common takeover method. It was an off-market bid, where conditions could be imposed by the bidder. Consideration could be in the form of cash or shares. The Part C bid was on-market. It had to be an unconditional cash bid. It was not allowed where the bidder’s pre-takeover shareholding was greater than 30 percent. The ‘creeping takeover’ provisions allowed the acquiring company to buy no more than 3 percent of voting shares in any six month period.<sup>37</sup> Partial bids were allowed, but if acceptances in excess of the required quantity of shares were obtained, they had to be pro-rated.

A serious criticism of the new Code in its early years was that it had no particular focus, and no coherent philosophy. Regarding the development of the code, businessman Ron Brierley commented that

the philosophy of improving the position of the small shareholder relative to other investors was lost sight of and changes were being made and everybody’s fancy ideas were being thrown in. The result is that the takeovers code hasn’t got a central theme. It isn’t a very practical document.<sup>38</sup>

32 R Baxt, “The New Takeover Code” (1979) 49(8) *The Chartered Accountant in Australia* 29 at 29.

33 This issue will be discussed in detail in section 3.

34 Australian Financial Review 5/11/79 “Last-ditch bid for an Act with teeth” 15.

35 H A J Ford, *Principles of Company Law*, Fourth Edition, Butterworths, 1986, p 556.

36 R Baxt, “Comment” in *Takeovers and Corporate Control: Towards a New Regulatory Environment*, Centre for Independent Studies, 1987, p 89.

37 These details on allowable takeover methods are still current under Chapter 6 of the Corporations Law.

38 *The Bulletin*, 29th June 1986 “NCSC: Run by Lawyers but Can’t Win a Case” 107

In the same vein, Bob Austin was quoted as saying

to see the purpose of the takeovers code required considerable work, and ... even the seven Attorneys General were not clear as to the purpose of the legislation.<sup>39</sup>

One of the authors of the legislation inadvertently provided some insight into the extent of political compromise required in drafting the bill, and some corroboration of Ron Brierley's charge that 'everybody's fancy ideas were being thrown in':

we tried to talk to people who have practical experience in company takeovers to get their views and assessments of some of the ways we have approached the matter in the new draft. This was done in an informal way and probably concentrated on getting their views on how to simplify the wording; how to refine parts of the draft... we have tried to strike a balance between the various points of view.<sup>40</sup>

It was not only in the development stage of the legislation that difficulties inherent in a federal system were felt; the administration of the co-operative system proved to be difficult. On the retirement of the first chairman of the NCSC, Leigh Masel, the Financial Review called the new corporate regulatory system "Australia's unique experiment in co-operative federalism."<sup>41</sup> The writer commended Masel's performance in a difficult role:

How many other people could have survived having 22 different bosses, who were more often than not simply pushing their own barrows over a 5 year period? Under the co-operative scheme, the NCSC... is accountable to the Ministerial Council, a body comprising the federal Attorney General and all State Attorneys General.

In defending CASA and the NCSC's administration of it, Masel was quoted as saying that the Australian system is "a better political and administrative model than any comparable federal system in the world."<sup>42</sup> It might be said that CASA was 'damned by faint praise,' when the writer made the comment that comparable federal systems - in the US and Canada - were 'hardly ideal models.'<sup>43</sup>

CASA survived with no major changes until 1985, when a few controversial amendments were made within a couple of years. The first was the Companies and Securities Legislation (Miscellaneous Amendments) Act (1985), whose most important inclusion was an amendment to the allowable conditions in Part A bids. Conditions whose fulfilment depended on an opinion of the bidder or the happening of an event in the sole control of the bidder were banned.<sup>44</sup> In 1986, pro-rata partial bids were disallowed, along with escalation clauses. These amendments were accompanied by a shift in the environment against takeovers, as certain well-publicised issues created a considerable anti-takeover feeling in the community.

The debate over the merits of takeovers came to a head with Robert Holmes a Court's bid for BHP in early 1986. Negative perceptions of takeovers were being fuelled by the media's daily reports of the BHP bid and the canvassing of much (largely ill-informed) opinion regarding the

39 Ibid, at 107.

40 Australian Financial Review, *supra*, n 34, at 15.

41 Australian Financial Review 17/2/85 "The parting thoughts of Chairman Leigh" 10,11,18.

42 Sydney Morning Herald 27/6/83 "NCSC: a well-made machine to guide corporate development" 17,18 at 18.

43 Ibid.

44 A O'Connell "Recent Amendments to the Takeovers Code" (1987) 61(1/2) *Law Institute Journal* 50 at 51.



damage that takeovers do to the economy, employment, the balance of payments, the budget deficit, and Australia's sovereignty, to name a few.<sup>45</sup> Some members of the government and the union movement advocated some very strong anti-takeover legislation. These calls were not merely for amendments to CASA. In the middle of 1986 there was a considerable push from within the Australian Labor Party (including some senior ministers) for restrictions on the tax deductibility of interest payments on debt used to finance takeovers. It was reported that although most members of the government, in particular the Treasurer, Mr Keating, did not approve of the proposed changes to CASA, "to stave off demands for changes to the corporate tax system - in particular to the present tax write-off for interest on borrowings for takeovers - the Government looks set to allow greater regulation of corporate takeovers."<sup>46</sup>

The change in public feeling coincided with the retirement of Leigh Masel as Chairman of the NCSC and his replacement by Henry Bosch. Leigh Masel had won considerable respect from the investment and legal profession for his handling of the very difficult period of the introduction of CASA.<sup>47</sup> He had a market-oriented, laissez-faire view of the market for corporate control, and considered that the extremely active takeover market during his tenure was a sign that he was doing his job properly.<sup>48</sup> It became apparent after Henry Bosch took over the chairmanship in early 1985 that his regime would be very different, when he made the famous comment that 'there are too many takeovers.' He subsequently made many public statements expressing a bias against certain types of takeovers, and an intention to make major changes to the legislation. For example, in an interview that appeared in *Australian Business* in February 1986, he said that during his chairmanship, he planned to "make it more expensive and more risky for the paper entrepreneurs to succeed." While he believed that "if there is a merger which leads to a rationalisation that leads to a reallocation of assets... then I'm all in favour of it," however, "if there's somebody who wants to sneak up on a company and make his quick buck and doesn't give a damn about what happens after that, then I don't think I'm so much in favour."<sup>49</sup> He had earlier expressed the view that "the pendulum may have swung too far in favour of the offeror company."<sup>50</sup>

With the advent of the Corporations Law in 1990, the provisions of CASA were transferred into Chapter 6 of the Corporations Law, with very few changes. The most significant change was the creation of the Corporations and Securities Panel, which shared some of the former discretionary powers of the NCSC with the new Australian Securities Commission.<sup>51</sup>

45 A summary of the arguments against takeovers which were popular at the time can be found in Bishop, Dodd and Officer, *supra*, n 9; L English, "The Economic Effect of Takeovers" (1987) 57(9) 30; J Elliot "John Elliot on the Takeover Debate" (1986) 38(4) *Professional Administrator* 16; and Dodd, *supra*, n 14.

46 *Australian Financial Review* 24/6/86 "ALP Anti-takeover push gains force" at 1.

47 This is discussed in section 3.

48 *Australian Business* 26/2/86 "The Watchdog" at 65.

49 *Ibid.*

50 Baxt, *supra*, n 14.

51 This issue is discussed in section 3.

### III. THE 'BLACK LETTER LAW' VERSUS SELF-REGULATION DEBATE.

One of the most important reforms to corporate control regulation currently proposed is the extension of the role and powers of the Corporations and Securities Panel (the Panel), which was established with the Corporations Law in 1990. The proposal will bring the Australian panel much closer in role and nature to the U.K.'s Panel, which has existed since 1968.<sup>52</sup> There has been considerable debate in Australia since then as to whether we would be better served by a system of self-regulation as exemplified by the London Code on the one hand, or a legalistic or "black-letter law" approach on the other.

Self-regulation is the approach to takeover regulation used in the U.K. Takeovers are regulated by the City Code on Takeovers and Mergers (often called the London Code), which is administered and enforced by the Panel on Takeovers and Mergers (the London Panel).<sup>53</sup> The Panel comprises professionals from the securities industry and business, and its rulings do not have the force of law. It has been used by many commentators in Australia as a model for good takeover regulation because of its flexible approach, its ability to act quickly in takeover disputes, and its impartiality and consistency in decision-making.<sup>54</sup>

Before CASA, regulation of takeovers was purely via black-letter law. There are two problems with this approach. Firstly, as with other areas of corporate and securities law, a legalistic approach encourages the evasion of the spirit, while adhering to the letter of the law. 'Loophole-closing' by legislatures is commonly followed by the identification and exploitation of new loopholes. As early as 1965, one commentator argued that this was the main problem with takeover regulation:

The sections of the (UCA) with regard to takeovers have grown piecemeal and in a haphazard manner. The trend of the legislation has been that, where any particular time it has become patent that the takeover transaction is being abused, the legislature has tried, by amending the Act, to prevent this abuse.<sup>55</sup>

Secondly, in enforcing the law, the courts may take a legalistic approach, rather than a broader view consistent with the spirit of the legislation. In 1986 Robert Baxt argued that under the UCA judgments on takeovers were more liberal than they had been since the Eggleston amendments,<sup>56</sup> the implication being that the more complex and prescriptive the legislation, the more literal the interpretation will be. In another forum, Baxt argued that

because the courts are unwilling despite the directions they have received to give the legislation the kind of interpretation that I believe it merits, the courts are not the appropriate body to handle the basic issues of the philosophy and interpretation of a piece of legislation.<sup>57</sup>

Comments on the inflexibility of the black-letter approach began to appear after the Eggleston amendments:

52 Block, *supra*, n 25.

53 H A J Ford and R P Austin, *Ford's Principles of Company Law*, 6th Edition, Butterworths 1992, p 696.

54 For a discussion of the merits of the London Code and Panel, see P Frazer "The Regulation of Takeovers in Great Britain" in *Knights, Raiders and Targets: the Impact of the Hostile Takeover* eds J C Coffee, L Lowenstein. and S Rose-Ackerman Oxford University Press, 1988, p 436.

55 Shtein, *supra*, n 18, at 64.

56 Baxt, *supra*, n 14, at 147.

57 Baxt, *supra*, n 36, p 93.

The shortcomings of the legislation are so vast and the technical approach and inflexibility so ponderous, that the code is already in need of major clarification and variation to make it practicable and workable.<sup>58</sup>

Another commentator expressed the same view, arguing that

after 25 years of commitment to the strictly legalistic approach, progress is really very limited....if for no other reasons that the wide range of possibility inherent in bid situations has constantly tended to defeat the ingenuity of the legal draftsmen - the law not surprisingly has proved insufficiently inflexible.<sup>59</sup>

Despite a widespread recognition of the problems of takeover regulation by means of black-letter law, early drafts of the legislation preceding CASA were purely legalistic. These drafts were extensively criticised for their inflexible, legalistic approach, and the ease with which lawyers would be able to find new loopholes.<sup>60</sup> Early on in the Ministerial Council's negotiations, a panel approach was rejected, despite its advocacy from various players, including the Company Directors' association and merchant banks.<sup>61</sup> It was opposed by most of the State corporate affairs departments and ministers. The associated stock exchanges advocated a number of detailed amendments to the legislation, and a greater watchdog role for themselves.<sup>62</sup> One of the strongest advocates for a panel system of regulation was NSW Attorney-General Frank Walker. This panel

would have been an Australia-wide panel, the rules of which would have had the force of law. A takeover panel was recommended by Mr Walker as he was trying to avoid a situation where one had a rigid attempt to regulate takeovers by means of fixed legislative rules. Each individual market would have been watched by a delegate of the panel, who would have dealt with day to day decisions in that market.<sup>63</sup>

Mr Walker's recommendations were rejected by the Ministerial Council on some fairly trivial grounds:

the benefits were at best marginal and certain administrative problems could not be resolved. Problems are understood to have arisen on such matters as the selection of members of the panel and the delegates, payment for the panel's operation and questions such as whether the panel's rules would replace existing stock exchange listing requirements.<sup>64</sup>

As discussed in section 2, the discretionary powers of the NCSC were a late addition in the development of CASA. Their purpose was to give the administration of the legislation more flexibility, by allowing exceptions to the letter of the law in specific circumstances, and by being able to declare certain conduct unacceptable if it breached the spirit but not the letter of the law. The discretionary powers of the NCSC were directed by section 59 of CASA, which stated that the NCSC should ensure "desirability of ensuring that the acquisition of shares in companies takes place in an efficient, competitive and informed market."<sup>65</sup> This section also directed the NCSC to ensure that takeovers were conducted with regard to the Eggleston principles. The section concluded with the policy objective of

58 Block, *supra*, n 25, at 242.

59 Australian Financial Review 1/7/76 "wanted: a takeover code with courage" at 3.

60 Far Eastern Economic Review June 1978 "Australia adopts a legalistic approach;" Australian Financial Review 16/1/79 "complex regulations will spur raiders to find loopholes" 22; Australian Financial Review 17/1/79 "how to drive a horse and cart through the new takeovers code" 24,27.

61 Far Eastern Economic Review, *ibid*.

62 Australian Financial Review 16/1/79 "complex regulations will spur raiders to find loopholes" 22.

63 Australian Financial Review 15/5/78 "Tougher new takeover code" 1.

64 *Ibid*.

65 Ford, *supra*, n 35, p 557.

the discretionary powers, which was “to discourage activities which would frustrate the aims of the code.”<sup>66</sup> Section 60 allowed the NCSC to make declarations of unacceptable conduct if at least one of the principles listed in section 59 was breached by “a specified person in relation to shares in, or the affairs of, the target company.”<sup>67</sup>

Leigh Masel saw the commission’s role in takeover regulation “to administer and formulate policy, investigate and conduct research in the area of the new takeover code.”<sup>68</sup> The philosophy behind CASA, and the NCSC’s role in its administration, was outlined in an NCSC policy release in 1981:

By investing the Commission with wide discretions, the legislatures implicitly acknowledge that acquisitions of substantial interest in a company and conduct in relation to takeover bids cannot be adequately regulated by precise statutory forms... The Commission’s exercise of discretionary powers will... provide a mechanism whereby reasonable commercial transactions will be unencumbered but any belief that what is not illegal [or cannot be demonstrated to the Courts to be illegal] is acceptable will be precluded.<sup>69</sup>

Some commentators expressed confidence that the NCSC’s discretionary powers would adequately address the problem of the inflexibility of black-letter law.<sup>70</sup> However, many predicted the subsequent problems resulting from CASA’s hybrid approach. One commentator predicted that the discretionary powers of the NCSC would be challenged in the courts:

While the NCSC has indicated that, in some ways, it hopes to act in a manner similar to that of the London Panel, there is no doubt that the NCSC’s decisions from time to time, will be appealed to the courts. The issues involved are then likely to take on more of a ‘legalistic’ character with the subtleties of the financial reality less to the fore.<sup>71</sup>

Robert Baxt anticipated the continuing legalistic approach of the courts, despite the hope that the new code would be interpreted more liberally.<sup>72</sup>

The early days of the operation of CASA were accompanied by a dramatic increase in the volume of takeover litigation. Not only was there confusion as to the extent of its discretionary powers; they were also considered by many to be ‘too wide’ and unprecedented.<sup>73</sup> At the root of the problems was a fundamental incompatibility between the two approaches which combined to form CASA’s unique system of takeover regulation. In an extensive critique in *The Bulletin* in June 1982, the writer argued that “It is a fundamental dichotomy between a ‘black letter’ code... and a system of administrative discretions designed to promote the spirit of the legislation which is at the heart of the NCSC failures in the courts.”<sup>74</sup> Chairman of the Sydney Stock Exchange, Frank Mullens, argued

66 M Leiblier and H Lanzer, “The Impact of the New Companies Act on Takeovers - A Review” (1982) 56 *Law Institute Journal* 679 at 683.

67 Ford, *supra*, n 35, p 606.

68 L Masel, “Chairman of NCSC Speaks on CASA” (1981) 16(1) *Australian Law News* 13 at 13.

69 Cited in Q. Digby “Flexibility in the Administration of the Takeovers Code” (1991) 9(5) *Company and Securities Law Journal* 343 at 346.

70 L Hitchens “The Regulation of Takeovers: The American and the Australian Experience” (1982) 5(1) *University of New South Wales Law Journal* 153 at 168.

71 Winsen, *supra*, n 7, at 105.

72 R. Baxt, R “The New Takeover Code” (1980) 8 *Australian Business Law Review* 51 at 53.

73 O’Connell, *supra*, n 44, at 195.

74 *Bulletin*, *supra*, 38, at 106-107.

that “it is not the NCSC...which is to blame: it is the system which allows the NCSC’s discretion to be challenged on arcane points of law.”<sup>75</sup>

Consistent with Robert Baxt’s prediction, the courts tended to continue their narrow interpretation of the law, despite the flexibility that CASA was supposed to bring to corporate control regulation.<sup>76</sup> Hitchens had also predicted this problem:

Much of the success or otherwise of the 1981 Code will depend upon the role to be played by the courts. Australian courts in this area could be characterised more by their pedantic and legalistic approach than by a flexible and realistic attitude which might seek to enforce the protective spirit of the legislation...The success of the 1981 code will depend upon the willingness of the courts to look to the substance of transactions, and to give effective meaning to the code’s discretions. It could be asked whether the courts are even the appropriate bodies. The cumbersome formality and delays in time do not sit well with the concentrated activity of a takeover.<sup>77</sup>

In responding to criticism about the volume of litigation, Leigh Masel argued that this was not only to be expected, but useful:

While the industry is on a learning curve in dealing with new and complex legislation, he says, a solid body of case law to accompany the legislation will be useful in the long run.<sup>78</sup>

However, from comments reported a few days later it is obvious that he thought the courts were taking a too-legalistic approach:

My concern is that the technique of drafting of statutes in detail in Australia may contribute to a reluctance on the part of the courts to examine the underlying bases of economic transactions. Any such approach tends to ignore the normative behaviour of market participants in organised markets. Efficient and fair markets are distinguished by the participants’ desire to promote high standards of professional competence and integrity. Many persons who are actively engaged in such markets would be frankly appalled if they were required to believe that anything, which on the face of it was not illegal, is within the realm of the acceptable in market terms. I am not aware of the extent that the courts have been invited to examine usages and customs of securities markets. If courts are to function in the way expected of them by the commercial community, this seems worthy of consideration.<sup>79</sup>

The NCSC itself was criticised for taking an overly legalistic approach, and for being too willing to go to the courts.<sup>80</sup> It was suggested that this was due to the fact that “the key men shaping corporate and securities law in Australia are lawyers.”<sup>81</sup> When Leigh Masel took up the chairmanship only a year or two before these comments were published, he envisaged a very different NCSC: “When fully staffed, the NCSC will be an interdisciplinary organisation, that is to say, its staff will comprise people who have varied vocational skills such as accounting, law, finance and economics.”<sup>82</sup>

75 Sydney Morning Herald 27/6/83 “NCSC: a well-made machine to guide corporate development 17, 18 at 18.

76 The Bulletin, *supra*, 38, at 107.

77 Hitchens, *supra*, n 70, at 168.

78 Sydney Morning Herald, *supra*, n 75, at 18.

79 Sydney Morning Herald 30/6/83 “ASA favours the companies Act” 15, 18 at 18.

80 The Bulletin, *supra*, n 38, at 106; and Sydney Morning Herald 25/6/83 “Legal profession critical of NCSC, Companies Act” 26.

81 The Bulletin, *supra*, n 38, at 106.

82 Masel, *supra*, n 68, at 13.

A quotation from a Sydney lawyer sums up the problems with the early years of CASA:

Australia's takeover law is defective, its administration incompetent and millions of dollars of investment capital are being wasted in complying with its complexity. It is, moreover, restrictive, its administrators are often not impartial and it has failed to meet its objectives. The sooner lawyers get their sticky beaks out of the way and let the market process take its course unfettered by black letter law the better.<sup>83</sup>

The problems in the early years of CASA's operation were seen by many as merely teething problems. Leigh Masel was largely perceived as being impartial and doing a good job with an imperfect system. It was not until the second half of the eighties, and the appointment of Henry Bosch as chairman, that criticism focussed much more strongly on the NCSC itself. Throughout Bosch's tenure, the NCSC was subject to extensive criticism on the grounds that its powers were far too wide, and that it was acting beyond its authority. For example, Graeme Samuel of Macquarie bank, in questioning the NCSC's commissioning of a study into the benefits of takeovers, commented that

it is not part of the NCSC's charter to be examining the economic impact of takeover offers...it's the same as saying that the chief commissioner of police ought to be the one to determine whether abortions are a good thing or not.<sup>84</sup>

Referring to the NCSC's powers regarding policy, lawyer John Green argued that

It is none of the NCSC's business to question whether there are too many takeovers. Its function as far as takeover policy is concerned is limited to ensuring that takeovers, however many there are, are run fairly and within a framework that fosters market confidence and efficiency. In my view the NCSC should get its nose out of this debate.<sup>85</sup>

But by far the most widespread criticism, mainly from the legal profession but also from the investment and business communities, was that the NCSC acted as "policeman, prosecutor, judge and jury."<sup>86</sup> This disquiet regarding about the NCSC came to a head during the BHP bid in 1986. The NCSC made a declaration of unacceptable conduct against John Elliot, Allan Hawkins and Richard Pratt for defending BHP in a 'white knight' rescue attempt. The unacceptable conduct ruling was overturned on appeal to the courts. The NCSC was singled out for particular criticism by the presiding judge, who launched a 'humiliating 90-minute tirade' against it.<sup>87</sup>

As a response to this public disquiet over its powers, the roles of the NCSC were split when takeover regulation was incorporated into the Corporations Law in 1990. The ASC was granted the investigative role, while the Panel was established for the adjudicative function.<sup>88</sup> Compared to the discretionary powers of the NCSC, the role of the Panel is limited; the most crucial limitation is that it can only hear matters referred to it by

83 Sydney Morning Herald, supra, n 80, at 26.

84 Australian Business, supra, n 48 at 65.

85 J Green, John, "Discussion - Sydney" *Takeovers and Corporate Control: Towards a New Regulatory Environment* Centre for Independent Studies, 1987, p 101.

86 See Elliot, supra, n 45; N Renton, "Company Takeovers: Some Reforms Needed" (1984) May *National Australia Bank Monthly Summary* 11at 4; Business Review Weekly 27/2/87 "Role of Watchdog Still a Controversy" 119; J Green "An Australian Takeover Panel - What Do We Want? A Panel Poll and Critique" (1989) 7(1) *Company and Securities Law Journal* 6 at 7.

87 In G Haigh, *The Battle for BHP*, Information Australia, Melbourne, 1987, p 110.

88 W Kent, "Takeovers - the New Rules" 1989 7(6) *Company and Securities Law Journal* 415 at 419.

the ASC. One of the main concerns early on was that the limitations on the Panel's operation would inhibit the ability for the legislation to be administered flexibly. One commentator argued that this would result in a much reduced likelihood of a declaration of unacceptable conduct.<sup>89</sup> In retrospect he appears particularly prescient; since its inception in 1991 there have only been three referrals to the Panel, and takeover disputes have still been largely resolved in the courts.<sup>90</sup>

The current proposals for the widening of the Panel's role are aimed at replacing the courts as the main resolver of disputes. The Panel will have the power to declare conduct unacceptable and make orders. All interested parties, rather than just the ASC, will be able to refer matters to the Panel. Appeals to the courts will be restricted.<sup>91</sup> In advocating this change to the Panel's role, the CLERP takeovers document acknowledges that litigation has been used as a tactical weapon in disputed takeovers, and envisages that a reformed Panel can act much more quickly and efficiently than the courts. Other advantages envisaged by the CLERP committee are that there should be more informality and consistency in decision making.<sup>92</sup>

#### IV. SKEWNESS TO TARGET SHAREHOLDERS

The Australian system of takeover regulation is skewed toward the protection of target company shareholders. The four Eggleston principles, which have constituted essentially the only philosophical framework in Australian takeover regulation since 1971, are all directed at protecting the target shareholder. The fourth Eggleston principle in particular - the equality principle - has been singled out for particular criticism by some commentators. It has been argued that the equality principle has made corporate takeovers so costly, that potential bidders are put off, thus severely impeding the market for corporate control. Given the costs, critics have questioned the need for such 'protection' of target shareholders.

Before these issues are discussed, it is worth looking at the background to the Eggleston principles. At the Centre for Independent Studies takeovers conference in 1987, Robert Baxt made some telling comments about the development of the Eggleston principles, and recommended a review of the need for the equality principle:

A special committee was appointed by the Attorney-General to look at takeovers, and it was given one month, over Christmas, to consider the issue. After one month of marathon sitting the committee came down with four propositions that it suggested were the criteria that should be essential to our takeover code...The one that has caused the most difficulty is the question of equality of opportunity wherever practicable...It seems to me that now is the time when those criteria, which were brought forward after one month of study and no discussion period allowed, should be seriously reviewed.<sup>93</sup>

It was not until CASA that the Eggleston principles were specifically written into the legislation and became the overriding focus of takeover regulation in Australia. As documented in section 2, regulation under the post-Eggleston UCA was much more *laissez-faire*, allowing takeovers which were in apparent conflict with the equality principle: unregulated on-market bids, unregulated purchase of block shareholdings, unrestricted

89 Digby, *supra*, n 69, at 345.

90 CLERP, *supra*, n 1, p 32.

91 *Ibid*, p 37.

92 *Ibid*, p 32.

93 Baxt, *supra*, n 36, at 93.

partial bids, and allowing principles to remain anonymous. It would probably have surprised Sir Richard Eggleston that the equality principle was followed so slavishly within CASA.

#### **4.1 The Importance of the Market for Corporate Control**

The skewness in Australian takeover regulations toward the target shareholder has had a serious impact on the efficient workings of the market for corporate control. This is because, as target shareholders are protected, inefficient target management may also be protected. One of the most important roles of the market for corporate control is to discipline incompetent or profligate managers, or those not acting in the best interests of shareholders. This is especially important for companies in which there are dispersed shareholdings where no individual shareholder has sufficient power to discipline or replace inefficient management. An efficiently functioning market for corporate control is essential for the efficiency of industry and commerce, and the health of the economy.<sup>94</sup> For the market for corporate control to operate effectively, takeovers do not actually have to occur in large numbers; the threat of takeover is often sufficient to improve the performance of management.

Many commentators have argued that the skewness in the regulations has damped takeover activity to the detriment of the health of the economy. In a strongly worded paper, Winsen argued that the provisions of CASA

provide windfall gains to the target's shareholders and undesirable protection for inefficient management - with a consequent reduction in the value of equity investment in general.<sup>95</sup>

A similar comment was made by a Sydney lawyer in the early years of the operation of CASA:

As to the Eggleston Committee's view of takeovers, the legislation has been biased so much to the protection of the target company in a takeover that it serves only to entrench inefficient managements, to the cost of their shareholders.<sup>96</sup>

More recently, lawyer John Green has argued that our takeover laws are impeding the efficiency of the market for corporate control:

Unlike in other sophisticated markets, Australian takeover activity is hindered by costs and uncertainty, largely created by cumbersome rules and excessive litigation. Rather than being protected, small shareholders are made worse off.<sup>97</sup>

Green presented a compelling combination of evidence that the market for corporate control is now highly inefficient. While takeover activity had recovered in the UK and the US since the recession of the early 90's, this had not occurred in Australia. Takeover activity as a percentage of total market capitalisation remained at a very low 1 percent.<sup>98</sup> He also argued that because Australian management was not subject to an efficient market for corporate control, they were not managing the assets of their companies optimally. To back up this assertion he presented evidence that the return on shareholders funds for Australian companies, for the five

94 There is an extensive literature on the importance of the market for corporate control. For a review of the relevant Australian literature, see E Hutson "The Market for Corporate Control in Australia" (1997) 16(2) *Economic Papers* 51.

95 Winsen, *supra*, n 7, at 93.

96 Sydney Morning Herald 25/6/83 "Legal profession critical of NCSC, Companies Act" 26, 28 at 28.

97 J Green, Australian Financial Review 10/11/97 "Make takeover law discipline managers."

98 J Green, presentation at CLERP Seminar, Sydney, Thursday 13th November, 1997.



years to 1996, was 8.4 percent, compared to the US average of 18.3 percent.<sup>99</sup> The irony is that, on the grounds of fairness and equity, takeover regulation has made it so difficult and costly for bidding firms to launch takeover bids, that shareholders of firms which perhaps should be subject to takeover bids are disadvantaged.<sup>100</sup>

#### 4.2 Do Shareholders Need This Sort of Protection?

In a recent paper, Justin Mannolini argued that the equality principle is in urgent need of reform.<sup>101</sup> He advocated the abolition of the equality principle, arguing that there are other safeguards in corporate law to protect shareholders. He also argued that the protection of target shareholders is increasingly less necessary because shareholders these days have many methods at their disposal to reduce risk: highly liquid capital markets, principles of portfolio diversification, and use of derivatives securities. Another argument against the necessity for the equality principle - which is essentially to protect small, less well-informed shareholders - is that share ownership is dominated by institutions. In 1993, only 12 percent of Australian shares were held by individuals, compared to 40 percent in 1980.<sup>102</sup> A huge burden is placed on business in the name of 'protecting' a small number of individuals.

However, despite the disquiet over the equality principle, it seems that in the current review of the takeover legislation the equality principle will be retained.<sup>103</sup> Further, the importance of the protection of small investors is explicitly recognised in the CLERP 'policy framework' document. One of the CLERP's six 'key principles' is:

Investor protection: With an increasing number of retail investors participating in the markets for the first time, business regulation should ensure that all investors have reasonable access to information regarding the risks of particular investment opportunities. Regulation should be cognisant of the differences between sophisticated and retail investors in access to information and the ability to analyse it.<sup>104</sup>

The trend of falling individual share ownership over the last few decades is now reversing with huge retail interest in the floats of government-owned enterprises such as the Commonwealth Bank and Telstra. It is therefore likely that, in the future, there will be increasing political pressure to 'protect' the interests of small shareholders.

#### 4.3 The Partial Bid Debate

The history of the partial bid debate is particularly interesting because it illustrates changing perceptions of what is considered 'fair' to target shareholders. Partial takeover bids are those where the bidder attempts to acquire less than one-hundred percent of the voting shares of a company. Generally speaking, the bidder in a partial takeover attempt wants control of the target firm, but not full ownership. In 1986, the Companies and Securities Legislation Amendment Act was passed, which had the effect of virtually banning partial takeovers.

99 Green, *supra*, n 97.

100 This criticism has also been made in reference to the disallowing of pro-rata partial bids; refer section 4.3.

101 J Mannolini, "The Reform of Takeovers Law - Beyond Simplification" (1996) 14(8) *Company and Securities Law Journal* 471; see also Winsen, *supra*, n 7.

102 B Hunt and C Terry, *Financial Institutions and Markets*, Nelson ITP, Melbourne, 1997, p 352.

103 CLERP, *supra*, n 1.

104 CLERP *Policy Framework* 1997, p 3.

Prior to this amendment, two methods of partial takeovers were permitted under CASA. In a **pro-rata partial** bid, the bidder specifies the proportion of voting shares he or she wishes to acquire. If acceptances are received for more than this number, the acceptances must be pro-rated; for example, if the bid is for 40 percent of voting shares, and acceptances are received for 80 percent, then each shareholder may only sell half of his or her shareholding to the bidder. The second method is the **proportional partial** bid, where the bidder specifies the proportion of each shareholders' holding that it wishes to acquire. For example, if the bid is for 50 percent of each shareholder's holding, and acceptances are received from shareholders holding 50 percent of voting shares, then the bidder will only gain control of 25 percent of shares. The 1986 amendment disallowed the use of pro-rata partial bids. These provisions are now included in section 635(b) of the Corporations Law. The U.K. regulations essentially ban partial bids,<sup>105</sup> while in the U.S. partial bids require pro-rating.<sup>106</sup>

Prior to CASA there were no restrictions on partial takeover bids. The Eggleston committee recommended against the compulsory pro-rating of partial bids, commenting that

Such a rule would, we think, involve great difficulties, and we do not see any escape from the position that it is impossible to secure complete equality in this respect.<sup>107</sup>

The compulsory pro-rating requirement in CASA was introduced as a reaction to public perception that partial bids were unfair to target shareholders: only those that accepted would receive the 'control premium' while others would miss out completely.<sup>108</sup> Consistent with the equality principle, the pro-rating provisions gave accepting shareholders the opportunity to participate equally in the 'control premium.' The pro-rating provision brought the Australian legislation in line with U.S. legislation. However, when the pre-CASA draft bills were being circulated, many commentators questioned the formal recognition of partial bids, because they were essentially banned in the UK.<sup>109</sup>

Despite the fact that the pro-rating requirement was introduced on the grounds of equality of opportunity, by the mid-1980's pro-rata partial bids were beginning to be seen as 'unfair.' They were seen as giving bidders an unfair advantage by being able to acquire control of a company without paying full price. The more serious criticism was that pro-rata partial bids coerced target shareholders into accepting the bid, irrespective of their opinion as to its merits. It can be argued that target shareholders are subject to the 'prisoner's dilemma':

Shareholders may find the overall partial offer unattractive because they do not want to be minority shareholders at the completion of the partial takeover. However, if a shareholder does not accept the partial offer but others do, so that the partial takeover is successful, the shareholder has missed out on receiving the attractive offer price for part of the shares held. Shareholders with no confidence in the actions of other shareholders will accept a

105 See Ramsey, "Balancing Law and Economics: the Case of Partial Takeovers" 1992 July *Journal of Business Law* 369 at 384; also Frazer, *supra*, n 54.

106 See R Sappideen, "Takeover Bids and Target Shareholder Protection: the Regulatory Framework in the United Kingdom, United States and Australia" (1986) 8 *Journal of Comparative Business and Capital Market Law* 281 at 293, 298-99.

107 Eggleston, *supra*, n 26 at 62.

108 Australian Financial Review 15/5/78 "tougher new takeover code" 1.

109 Australian Financial Review 17/1/79 "How to drive a horse and cart through the new takeover code" 24.

partial bid even though it may not be in their best interests or indeed the best interests of the other shareholders.<sup>110</sup>

It has also been argued that partial bids disadvantage small shareholders because they are more likely than large or institutional shareholders to accept the advice of the target board to reject the bid, and so do not participate in the control premium.<sup>111</sup>

In 1985 the Companies and Securities Law Review Committee (CSLRC) released a discussion paper and then a report on partial takeover bids. The committee's position was that pro-rata partial bids were coercive, but that there was a role for partial bids in an efficient market for corporate control. The committee recommended that partial bids should be confined to proportional bids.<sup>112</sup> In a strongly-worded critique of the CSLRC's paper, lawyer Simon Hannes took issue with the committee's recommendation. He argued that there was insufficient evidence of the ills of pro-rata partial bids, and that "at times the reasons given by the committee for their recommendations are demonstrably unsound."<sup>113</sup>

It is likely that the impetus for the banning of pro-rata partial bids also came from the NCSC. In February 1986 Chairman Henry Bosch was reported as having considerable powers of persuasion with the Ministerial Council; on partial bids he said "that was put to the ministers as an equity matter and they accepted it completely..."<sup>114</sup>

The BHP takeover bid in 1986 brought the partial takeover issue to public attention. Robert Holmes a Court's second bid for BHP coincided with the proposals to ban pro-rata partials, so he withdrew it and launched a proportional partial bid. Journalist Gideon Haigh explained the widespread interest in the affair:

In the past, business was the section of the newspaper that lined the nation's rubbish bins first. It was antediluvian, abstruse and avoidable. But the tremors as BHP locked horns with Robert Homes a Court (on paper, Australia's richest man) and John Elliot registered everywhere. Holmes a Court's puckish expressions stared from the newspaper front pages. Elliott's rakish, piratical gait became familiar on television. Even the austere manager director of BHP, Brian Loton, found a niche in prime time. Politicians, analysts, unionists, bankers, company regulators and columnists began to doubt out loud whether it was all worth it.<sup>115</sup>

One of the most serious criticisms of the banning of pro-rata partials was that this would eliminate partial bids.<sup>116</sup> Bidders would be reluctant to make a proportional bid because they would bear too much outcome risk. It would also be difficult to know what proportion of the company to bid for. If, for example, the bidder wanted 40 percent, it would be advisable to bid for a greater proportion than this because not all shareholders would accept. However, the difficult question would be what proportion to bid for? Bidders would face the risk of obtaining too many acceptances. There would also be difficulty getting financing in place under such uncertain circumstances.

110 Bishop, Dodd and Officer, *supra*, n 9, p 65.

111 S Hannes, "The Partial Bid Debate" (1985) 3(3) *Company and Securities Law Journal* 162 at 163.

112 V Nagarajan, (1986) "Partial Takeover Bids and the Proposed Amendments" (1986) 11(2) *Legal Service Bulletin* 89.

113 Hannes, *supra*, n 111, at 165.

114 Australian Business 26/2/86 "The Watchdog" 64 at 65.

115 Haigh, *supra*, n 87, p 1.

116 O'Connell, *supra*, n 44, at 52.

It appears that this was Bosch's plan. In his book published in 1990 he boasts that of all the amendments to CASA during his reign as Chairman, by far the most important of these changes was the virtual elimination of partial takeovers. When I came to the commission many senior businessmen told me that partials were the worst feature of our takeover system and I was glad to use my influence to help restrain them. ....while partial offers for a proportion of each shareholder's holding continued to be allowed, they have hardly ever been used. Partial takeovers have been almost entirely eliminated from our system.<sup>117</sup>

The evidence bears out Bosch's assertion. Proportional partial bids have not proved to be an attractive option for bidders. In 1987, 1988, 1989 and 1990, partial bids comprised respectively 6 percent, 5 percent, 2 percent and 4 percent of total bids launched, compared to about 40 percent in 1982.<sup>118</sup>

In contrast to Henry Bosch's opinion on partial takeovers, his predecessor Leigh Masel had a less biased view. On his retirement in 1985 Masel was quoted as saying that "I simply do not believe that many of the reasons that are put forward to curtail partial bids could be sustained by empirical data."<sup>119</sup> He was right; the arguments that partial bids are unfair and coercive are clearly exaggerated. There was some quality empirical evidence to this effect available when the amendment was under discussion. Most significantly, an empirical paper by Peter Dodd,<sup>120</sup> refuting most of the claims of the anti-partial camp, was attached as an appendix to the CSLRC discussion paper. This paper, and one published a year later, presented evidence that the wealth effects of partial takeovers are not significantly different from those which occur in full takeover bids.<sup>121</sup> While Bosch described partial bids as being 'extremely common,' they were relatively rare. In the period 1972 to the middle of 1985, only 12 percent of takeover bids were partials.<sup>122</sup> Further, after CASA, the use of the pro-rating provisions was also relatively rare: during 1981-83, only 22 percent of 26 partial bids used the pro-rating provisions.<sup>123</sup>

If the argument that partial bids are coercive was true, there would be a high level of successful partial bids. This is not the case. For example, for takeover attempts during 1983 and 1984, the success rate for full bids was 70 percent whereas it was only 50 percent' for partial bids.<sup>124</sup>

117 H Bosch, H. *The Workings of a Watchdog* William Heinemann Australia, Melbourne, 1990, p 155.

118 Ramsey, *supra*, n 105, at 373.

119 Australian Financial Review 17/2/85 "The parting thoughts of Chairman Leigh 10, 18 at 18.

120 The substance of Dodd's findings can be found in S Bishop and P Dodd, (1987) "Partial Takeovers: Are they Coercive?" (1987) 12(1) *Australian Journal of Management* 9. In their introduction, Bishop and Dodd note that this appendix was 'presented with little embellishment and appears to have been ignored in both a subsequent report prepared by the CSLRC and by those participating in the debate' at 10.

121 Bishop, Dodd and Officer, *supra*, n 9.

122 *Ibid*, at 21.

123 Bishop and Dodd, *supra*, n 121, at 21.

124 Business Review Weekly 21/3/86 "Rational light on merger myths" 64, 68 at 64.

## V. CONCLUSION

The purpose of this paper has been to describe and evaluate the process of regulatory reform of the market for corporate control in Australia. The paper first reviewed the history of takeover legislation, from the Uniform Companies Act (1961) to the proposed changes to Chapter 6 of the Corporations Law under the Corporate Law Economic Reform Program. It then described the history of major legislative changes and the associated debate behind two problematic features of the regulatory system: it is a hybrid of 'black-letter law' and self-regulation approaches; and it is heavily skewed towards the protection of target shareholders.

The main conclusions of this paper are: *first*, the process of regulatory reform has been haphazard and unduly influenced by short-term political imperatives. *Second*, the issue of the method of regulation has been a dominant theme throughout this process, and has not been successfully resolved. There has been far too much court involvement in the resolution of takeover disputes. Even with the proposed expansion of the role of the Corporations and Securities Panel, the system will remain an uneasy hybrid. *Third*, the focus of the regulation on the protection of target shareholders has created a system which is so costly and uncertain for potential bidders that it inhibits the takeover process, and therefore seriously impedes the efficient workings of the market for corporate control. The proposed follow-on rule may go some way to overcome this problem, potentially reducing the risk to acquirers.