SECTION 23 OF THE COMMONWEALTH COMPANIES (ACQUISITION OF SHARES) ACT

The Securities Institute of Australia ("SIA") has been asked by the National Companies and Securities Commission to comment on certain aspects of Section 23 of the Commonwealth Companies (Acquisition of Shares) Act.

Section 23 of the Act provides that in specified circumstances where the offeror is connected with the target company, the Part B Statement shall be accompanied by a copy of a report made by an "expert" (not being a person who is associated with the offeror or the target company) stating whether in his opinion the takeover offer is "fair and reasonable" and setting out his views for forming that opinion. An "expert" is defined as a person whose profession or reputation gives authority to a statement made by him in relation to a particular matter.

General Comments
Consistent with its belief in the precepts of full disclosure and the operation of market forces, the SIA considers it would be inappropriate to formally regulate either the qualifications necessary to be an expert or the contents of the expert’s report.

The needs of the marketplace and the satisfaction of those needs are best determined and provided by the market itself. This is clearly demonstrated by the fact that market forces have been responsible for the introduction and development of experts reports in takeover transactions. Since it is the market which is the ultimate judge of the acceptability of an expert’s advice and thus the reputation on which his status depends, effective sanctions are imposed on substandard and inadequate reports. Unfortunately these sanctions do not necessarily result in immediate redress of reporting deficiencies but nevertheless it is evident that the quality of expert advice has generally improved over time.

The SIA believes that many of the valid criticisms of experts reports can be eliminated, not through specific regulation and guidelines, but by requiring full disclosure of all pertinent information to the opinion made by the expert and allowing market forces to adjudicate on that opinion. An expert’s opinion on the merits of a takeover offer is, by its very nature, a matter of judgement rather than a precise science. Thus it is the reasons leading to that opinion which are crucial to a shareholder in deciding whether or not to accept a takeover offer.

By publicly disclosing in detail the methodology and analysis employed in arriving at his decision, the expert would enable the market to make an informed assessment of both the quality of the advice given and the merits of accepting that advice. Similarly if the expert was required to disclose both his association, if any, with the offeror and the target company and his qualifications and experience as an expert, the market would be in a position to assess the degree of credibility which should attach to the report.

Who is an Expert for Purposes of Section 23
The SIA believes it is impractical to prescribe qualifications for an expert for purposes of Section 23. The wide ranging expertise that is necessary to carry out a competent assessment of a takeover offer is largely gained through experience. Academic qualifications may contribute towards expertise in this area but are not sufficient, by themselves, to create an expert.

Although the required expertise is a function of experience it is not possible to quantify exactly the amount of
experience that qualifies a person to be an expert in the field. Any time limit placed on experience would be merely an arbitrary threshold incapable of logical justification.

A better approach would be to require disclosure of the expert’s qualifications and experience so that the market is fully informed and can conduct its own assessment. If the market considers that such qualifications and experience are inadequate and that this is reflected in the standard of the advice given, then the experts reputation will suffer accordingly with the likely consequence that future demand for his services will be curtailed.

The SIA has considered the suggestion that the National Companies and Securities Commission should establish a register of experts. For the reasons outlined above the SIA believes this proposal is not desirable. Not only is it impractical to set down qualifications necessary for entry into such a register but also there is the danger of creating either a perpetual “exclusive club” through setting high standards or opening the register to large numbers of “experts” and conveying on them unjustified authority by the mere fact of registration.

Persons Deemed to have a Relevant Association with the Offeror or Target Company

The SIA has not sought legal advice on the meaning of “associated” in Section 23 of the Act and the possible effect on subsections 7(5) and 7(6) on the interpretation of that term. Accordingly the comments below should be read in that context.

While the SIA shares the view that the protection provided by Section 23 should be both fair and seen to be fair, considerable difficulties do exist in delineating that degree of association of the expert with the protagonists which would taint his opinion. The position at either end of the spectrum is clear but the cut-off point in between is vague. A major shareholding, cross-directorships or an advisory role with the offeror generally would be seen to disqualify the expert from acting. However, a money market lending or portfolio management relationship may or may not depending on the circumstances.

This suggests that each case should be assessed on its merits. Such assessment is best carried out, and enforced, by the marketplace. If the expert’s association with both the offeror and the target company was adequately disclosed in the Section 23 report the market itself would establish the acceptable level of association. An expert’s existence depends on his reputation and he can ill afford adverse media and market comment. Indeed the prospect of public criticism over the presence of an unacceptable relationship will usually ensure that the expert does not seek appointment or is not invited to by the target company.

The question of whether an auditor of a target company should be regarded as having a relevant association with that company is a matter of diverse opinion. Some audit relationships are supplemented by the provision of taxation executive staff procurement and management consultancy services which tend to lessen the perceived independence of their role. In addition questions have arisen within the securities industry as to the competence of auditors in performing the expert’s task. On closer investigation these questions appear to stem from the lack of disclosure of reasoned analysis that has been a common feature of Part B Statement opinion letters prepared by auditors to date.

Perhaps the issue of auditors could be best resolved by applying the full disclosure recommendations contained in this submission rather than treating them as a separate category. By informing the market of their association with the target company, including any non-audit relationships, and requiring complete disclosure of supporting reasons for opinions expressed in their report as well as their qualifications and experience to perform the task, the marketplace can determine for itself the reliance to be placed on their opinion.

Criteria Necessary to Establish Fairness and Reasonableness

As stated earlier, the SIA considers that the market is the best judge of what constitutes an acceptable takeover offer and provided that it is fully and impartially informed it can perform that function in an efficient and equitable manner.

An expert’s report can significantly assist in this process if it discloses in full the rationale for the opinion expressed. Problems currently encountered are primarily due to the lack of disclosure of supporting reasons for that opinion. The opinion itself is a matter of judgement and although it may have been expressed by an “expert” its credibility must depend on the analysis undertaken to arrive at that conclusion. By requiring disclosure of the analysis the market can assess whether deficiencies exist in either the methodology employed or the analysis itself, or whether the reasons do in fact support the conclusion.

The proposal that guidelines be established on criteria for assessing a takeover offer suggests that the “experts” are not sufficiently qualified to perform their task. Moreover it contains a suggestion that the task lends itself to a “textbook” approach. This latter suggestion is certainly not sustainable since many of the factors affecting the valuation of a particular company are individual to that company and cannot be adequately assessed by applying some predetermined criteria and method of approach.

If it is proposed that the guidelines merely outline the common methods employed in security analysis and company valuations, such as capitalisation of maintainable earnings, identification of surplus assets and underutilised gearing capacity, net realisable values on an orderly liquidation and such like, then the proposal would seem redundant since an expert could hardly contend to be such if he
was not completely knowledgeable on such concepts. Furthermore, if he did lack this knowledge it would be patently evident once his report showing the supporting analysis was published.

One area where confusion may arise is the possible misinterpretation of the concept of “fair and reasonable” in relation to whether it is in the shareholder’s best interests to accept a takeover offer. Obviously if an offer is concluded to be fair and reasonable the adviser is recommending acceptance to shareholders.

However if the contrary conclusion is reached there are circumstances in which it may be in the interests of shareholders to accept. This distinction arises because market usage of the term “fair and reasonable” contains the meaning that the offer price is substantially equivalent to the highest price that could be realised for all the shares in the company assuming that the owners and directors adopted a course of action that would maximise the selling value of the company. In practice these conditions often do not exist. For example, where minority holders are locked in, a low dividend policy is pursued, low return assets surplus to operating requirements exist and so forth. In these instances, and given the alternatives available, it may be in the interests of shareholders to accept the offer notwithstanding that it is not fair and reasonable. Accordingly the expert opinion should be permitted and encouraged to address and advise on such circumstances.

Finally, to enable the expert to prepare a complete and faithful report, it is submitted that no information relevant to the task should be withheld by the company and that no instructions should be given to the expert on how the valuation should be carried out.

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BOOK REVIEW

OIL SEARCH IN AUSTRALIA

by

C.E.B. Conybeare

Australian National University Press, Canberra

For a commodity which is so important in both an economic and investment sense, it is surprising how few books have been written about oil and gas in Australia.

In view of the intense interest in this vital area, it is timely that Dr. Conybeare who is Reader in Petroleum Geology at the Australian National University Canberra, has written a book specifically for the layman that is eminently readable and useful and which answers many questions about the history, activities and other aspects of exploration for petroleum in Australia.

For many political scientists and economists, petroleum is a subject for deep debate especially in regard to such matters as national ownership of petroleum reserves or pricing policies for crude oil, LPG and natural gas.

Wisely, Dr. Conybeare has avoided these controversial areas and has resisted the temptation to examine superficially the stock market aspects. Rather he has presented an objective view of the origin and search for petroleum, as well as an analysis of the political and economic considerations and restraints in the planning and implementation of exploration programs and in the development to the production stage of oil and gas fields.

For investors and financiers seeking a basic understanding of the Australian oil exploration industry, the chapters on the history of petroleum exploration, the generation and accumulation of oil and gas, and exploration prospects onshore and offshore will have most appeal.

The less technically oriented will be attracted more readily to the succinct coverage on proven reserves and potential resources, production technology and economic considerations, and Australia's future petroleum needs and outlook.

The comprehensive twelve page petroleum exploration glossary is a useful inclusion and there is an extensive list of references for further reading.

The book can be used as a ready reference but my guess is most readers will find its 151 pages so interesting and to the point that they will read it from cover to cover in one sitting.

NORMAN MISKELLY

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