Takeover makeover — what the market thinks

A survey of Australian business leaders shows sharply divided views on recent and proposed changes to the rules governing the Corporations and Securities Panel. The survey also shows disagreements in the market about the very purpose of the panel. John Green, Alastair Lucas and Robert Backwell summarise the results and make suggestions for further change.

Recent and proposed changes represent sweeping reforms to the Corporations and Securities Panel, the body set up in 1991 to ensure that unacceptable takeover tactics are not employed.

The Corporations Legislation Amendment Acts 1993 and 1994, which are yet to become operative in their entirety, implement several of the reforms proposed in an ASC discussion paper released in late 1993, and modify several of those proposals.

The survey described in this article was undertaken by Macquarie Corporate Finance Limited, the corporate advisory subsidiary of Macquarie Bank, to test the views of corporate leaders about changes in the operation of the panel.

The major changes in the new rules are:

- **Private hearings.** The panel’s inquiries will now be held in private unless the panel otherwise directs. Until now, hearings were to have been held in public unless the panel decided otherwise.

- **Qualified rules of procedural fairness.** The rules of procedural fairness will apply to an inquiry, except to the extent those rules are not consistent with the Act and Regulations. Until now, the legislation had, without qualification, required the panel to observe the rules of natural justice. A prior proposal specifically excluded the rules of natural justice. The current position is a welcome compromise.

- **Legal representation.** Under the new arrangements, parties can bring lawyers, or anyone else for that matter, to assist them at inquiries. The original proposal excluded the right to have lawyers represent parties.

- **Focus on inquisitorial nature of the panel’s task and the need to proceed expeditiously.** Proposed regulations governing the conduct of panel proceedings strongly favour written submissions and very strict time limits apply.

- **Expand the panel’s jurisdiction to include defensive tactics.** Under the new legislation, the definition of “unacceptable circumstances” in Section 732 of the Corporations Law — and hence the jurisdiction of the panel — has been extended to encompass defensive tactics employed by takeover targets. Until now, “unacceptable circumstances” had been limited to conduct of an acquirer.

1988 survey

In 1988, John Green (then a partner at Frechills) surveyed a wide range of directors, regulators, lawyers, financial advisers and finance journalists about the (then) proposed panel. Some of the views expressed by those surveyed were carried into law as enacted, and others were not. It seems from the changes that have now been effected that the legislature could have listened more closely to the market at that time. Some of the changes now being implemented reflect the market’s 1988 views as expressed in that survey. (The results of the 1988 survey are set out in the article “An Australian Takeover Panel — what do we want? A Panel poll and critique” (1989) 7 C.& S.I.S. 6).

1994 survey

In mid-1994, Macquarie Corporate Finance conducted a fresh survey to...
determine how business leaders felt about the key reforms to the panel now being implemented. We invited the chairman and chief executives of Australia’s largest public companies to respond. We also asked corporate advisers, lawyers, accountants and financial journalists – professionals active in fields which relate to issues in which the panel is likely to be interested. We distributed about 200 questionnaires and had a response rate of close to 50%.

Results of the 1994 survey
Perhaps the most striking feature of the 1994 Macquarie survey results was the strong divergence of views on key aspects of what the panel should have power to do, and how it should do it. Interestingly, views between occupational groups also differed sharply on a number of key issues.

A key point that comes from the survey is that the market is quite divided (or is it confused?) about the real purpose of the panel. (This is reflected in the discussion of questions 6 and 7).

Q1. Is the new timetable too restrictive?
The Macquarie survey indicated some reservations about the tightness of the timetable. Although 60% of respondents overall felt that the new timetable is appropriate, many of the occupational groups (non-executive company directors, lawyers and accountants) were almost evenly divided on the issue. The other occupational groups (executive directors, corporate advisers and journalists) were very comfortable with the new timetable.

Q2. Should panel inquiries be conducted primarily on the basis of written submissions by parties (as now enacted) or through hearings?
Respondents were split 50/50 on this issue, and the responses did not vary much between occupational types. Until the new approach is tested in a live example, there will be considerable uncertainty as to how this approach will operate in practice.

Our view is that, with care, the increased use of written submissions will help expedite the panel’s hearings without unduly prejudicing parties’ rights.

The opposition to the new approach is tested in a concert, though there is speculation that this might be so.

Q3. Should people, the subject of an oral inquiry before the panel, have the right to have a lawyer represent them or should they be required to speak for themselves (albeit with a lawyer present)?
This question was asked when the proposal was to prohibit legal representation altogether. In aggregate, there was strong opposition to that approach. Around two-thirds of respondents were in favour of people being able to use a lawyer to represent them at panel hearings.

However, when we came to look at the responses made by different occupational groups, things got more interesting. Company directors (executive and non-executive) wanted to be able to use a lawyer by a margin of almost two to one. After all, these are the people who are likely to face most of the questions at a panel inquiry. Lawyers went even further, being virtually unanimous that people be able to use a lawyer to represent them.

By contrast, corporate advisers and journalists were almost unanimous the other way, feeling very strongly that people should speak for themselves at panel inquiries.

The opposition to the proposal has proved worthwhile. It has resulted in a substantial shift, so that now parties will be able to be represented by any one they choose, lawyer or not.

Q4. Should the panel’s powers also cover defensive conduct by target company directors? (This is, of course, embodied in the new rules.)
There was strong support across all groups that defensive conduct should be within the panel’s jurisdiction. More than 80 per cent of respondents felt that the panel should be able to probe into defensive conduct, suggesting that the original omission of defensive conduct was an oversight. Given the continued use of litigation as a defensive tactic in many takeovers, it will be fascinating to see if, and when, the panel bares its teeth on this.

Q5. Should the panel’s jurisdiction include the review of ASC decisions on takeover matters (or should the decision be left to the Administrative Appeals Tribunal and the courts)? (This change is not included in the new rules.)
This was a suggestion initially put forward by John Green in his commentary on the 1988 survey. In the 1994 Macquarie survey a majority of respondents felt that the panel should have the power to review ASC decisions. Across occupational groups, there was a roughly even split except for accountants and corporate advisers, who were strongly in favour of extending the panel’s jurisdiction, and barristers, who were strongly opposed.

Once again, we put this extension of the panel’s powers forward as an appropriate focus for future law reform.

Q6. Where a breach of the takeover rules of the Corporations Law is suspected, but evidence is not available, should:
(i) the ASC investigate and, if warranted, institute court proceedings for the breach; or
(ii) the matter be referred to the panel, which is subject to lesser evidentiary and procedural requirements than the courts?
(This is, can “unacceptable conduct” occur where a breach of the law is strongly suspected, but is difficult to prove in court?) Example: Company A buys 20% of Company X. Company B (which, while a separate company, is a well known friend of Company A) then acquires, say, another 20% of Company X. There is no indication that Companies A and B are acting in concert, though there is speculation that this might be so.

There was exactly a 50/50 split between respondents on this issue (and the length of our question cannot be entirely to blame).

The lawyers had a preference of almost two to one for leaving circumstances such as this to the ASC.
Martini, Christine, Leap into LEPOs, December.
McMurtrie, John, Numbing numbers — do they add up? September.
McRobert, Andrew, Vital signs, September.
McTainsh, Wendy, Balancing acts — how managers count the cost, March.
Miskelly, Norman, How the resource nations are coming to terms, September.
Mustow, David, Why investors run hot and cold, June.
Newell, Graeme, Property — more volatile than you thought (with John MacFarlane), March.
O'Connell, Brendan, Securitisation: helps and hindrances, September.

Oh, Jennifer, The price of ignorance (with Michael Gearin), December.
Parker, Derek, Licensed to deal, March.
Raeburn, Victor, Cruel tax: what's wrong with the ATO's accruals tax? (with Gordon Thring), March.
Sinclair, Norman, Managing the manager, June.
Sinha, Tapen, ANN — a good little learner (with Clarence Tan), September.
Stanford, Jon, NBFI — non-bank or non-anything? (with Peta Taylor), June.
Starer, David, Bespoke attribution (with Les Balzer), March; How to tell if the price is right (with Les Balzer), June.
Sugianto, Richard, Guess work: estimation risk and portfolio performance (with Dave Allen), March.
Tan, Clarence, ANN — a good little learner (with Tapen Sinha), September.
Taylor, Peta, NBFI — non-bank or non-anything? (with Jon Stanford), June.
Thring, Gordon, Cruel tax: what's wrong with the ATO's accruals tax? (with Victor Raehurn), March.
Tritsiniotis, Mario, Asset allocation: doing it in style (with David Hartley), March.
Turnbull, Shann, Employee share plans: who wins? June; Can corporate governance add value? December.
Valentine, Tom, Equality — it's contagious, September.
Ward, Guy, Innovation — lifeblood or luxury? June.

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and the courts. The other occupational groups were either evenly split or had a preference for involving the panel.

Our own view is that the panel should not be used as a device to lower the evidentiary threshold for alleged breach of the Corporations Law where court action is available. However, we recognise the enormous evidentiary difficulties that arise for the ASC and the courts in takeover circumstances.

Q7. Where the letter of the Corporations Law has been observed (so that court action would be pointless), should the panel be used to investigate situations where the “spirit” of the Corporations Law is thought to have been breached? Example: An offeror makes an offer at $1.00 per share. On the last day of the offer, the offer is increased to $1.50, giving only a handful of institutions the opportunity to accept.

Around 60% of respondents felt that the panel should be used where a breach of the “spirit” of the Corporations Law may have occurred. (There was a roughly even split across occupational groups, except for executive company directors and lawyers, both of whom were strongly in favour of using the panel.)

Our view is that conduct can be “unacceptable” even if it is entirely legal and that it is entirely appropriate to use the panel in such cases. Indeed, this is its fundamental purpose.

Conclusion

The Macquarie survey indicates that the business community welcomes some aspects of the reforms to the panel, particularly the widening of the panel's jurisdiction to include defensive conduct.

In relation to some other key reforms, however, the jury is still out — and these are likely to be quite controversial in practice. They include:
• the tighter new timetable; and
• the heavier emphasis on written submissions.
• A summary of the survey results, in tabular form, is available from John Green, Macquarie Corporate Finance Limited, PO Box H68, Australia Square, NSW 2000.

Structured FRNs

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of 90-day bank bills. To calculate this we take the duration of the previous fund, divide it by the duration of the 90-day bill and then multiply by the market value of the portfolio. For securities which are very sensitive to changes in short-term rates, this can lead to an exposure many times its market value.

This latter approach raises a further point of possible contention — to what interest rates are we exposed? For a structured FRN with a term of two years we may find that the market value of the security changes in response to the two-year-maturity section of the yield curve, even though there is no change in the 0-1 year section. Is it suitable for a cash fund to be exposed to this section of the curve?

Conclusion

Structured FRNs may be a legitimate device for enhancing the return of a fund by taking a view on the future course of interest rates. However, the options embedded in these instruments need to be explicitly recognised and taken into account in estimating the market value and the effective exposure of a fund. Any fund which includes a significant proportion of these securities may not give capital security and rates of return commensurate with what is normally thought of as a cash fund.