The Securities Institute has made this submission to the Task Force on Stage 3 of the Corporations Law Simplification Program. The submission urges changes in the takeover provisions to reduce their complexity and remove loopholes.

This submission has been prepared by the Companies and Securities Law Subcommittee (the "Subcommittee") of the Securities Institute of Australia. It has been prepared in response to a request for comments from the Corporations Law Simplification Task Force in relation to Stage 3 of the Simplification Program. This submission deals only with the topic of takeovers as set out in Chapter 6 of the Corporations Law.

In addition to the issues in this submission, the Subcommittee endorses recommendations made by the Legal Committee of the Companies and Securities Advisory Committee in their March 1994 report on "Anomalies in the Takeover Provisions of the Corporations Law".

The issues raised in this report highlight the continuing conflict between:
(i) the application of the black letter law, as set out in Chapter 6; and
(ii) the power, vested in the Corporations and Securities Panel (the "Panel"), to deem conduct or acquisitions to be "unacceptable" by reference to the well known Eggleston principles.

In its attempt to legislate for every conceivable outcome and despite the inclusion of the Panel's "unacceptable conduct" regime, the operation of Chapter 6 is unnecessarily complex. Its application has resulted in many anomalous outcomes that may have been avoided under a less complex regime.

This submission will identify some of these anomalies that we believe should be addressed in a simplification of the Corporations Law. The list is not intended to be exhaustive but should provide an indication as to the main areas we believe require attention. They are based on real transactions where shareholders have been disadvantaged (sometimes severely) by actions permitted by the anomalies. Areas covered include:
- the entitlement provisions;
- downstream acquisitions;
- benefits;
- acquisitions of options/convertible notes;
- Part C offers;
- irrevocable undertakings; and
- other miscellaneous issues.

We have not sought to provide detailed solutions in this paper, but rather to document the substantial failings of the current, black-letter law. These failings are likely to be accentuated by a higher level of takeover activity in coming years after a sustained lull in takeovers.

The Subcommittee has previously documented shortcomings in the operation of the Panel and we believe that a more active Panel will be a prerequisite to an efficient takeover market. However, notwithstanding the future of the Panel, the Subcommittee believes the Simplification Program should address the major deficiencies of the present law. If the Task Force agrees with the contentions made in this paper, the Subcommittee would be pleased to provide further assistance to the Task Force to develop solutions to the problems identified.

THE ENTITLEMENT PROVISIONS

There are a number of problems relating to the operation of the concepts of "entitlement", "relevant interest" and "associate". Put simply, the complexity of the entitlement provisions results in (i) contravening transactions where no "real" contraven-
TAKEOVER LAW

Acquisition of shares without an increase in entitlement

Appendix A illustrates a situation where A wishes to acquire B. A is able to gain control of B by acquiring D's 35% shareholding in B. In this way, A is able to lift its holding in B to 60% without restriction under Chapter 6. This result is permitted because A is already entitled to D's 35% holding in B by virtue of A's 20% holding in D, which gives A a deemed relevant interest in the 35% holding.

Increasing entitlement without acquisition

Appendix B illustrates a situation where company A (which already owns 10% of company C) is offered a further 5% parcel of C. Clearly, control of C would not change and A's entitlement to C's shares would not exceed 20%. However, this transaction would contravene Chapter 6 on the basis that Section 615 prohibits any person's entitlement exceeding the threshold.

In this illustration, X is presently entitled to 20% of C (10% deemed relevant interest through its shareholding in A and 10% deemed relevant interest through its shareholding in B). If A acquires a further 5% of C, X's entitlement will rise from the threshold level of 20% to 25%.

Becoming an "associate"

It is possible for two or more parties to become associated with a view to controlling a company without an offending acquisition taking place. Appendix C illustrates a situation where A and B each hold 25% of C. A and B can elect to become associates of each other and, therefore, control 50% of C. As long as any association agreement is drafted in a way that prevents A and B having relevant interests in each others' shares, there will be no contravention of Section 615.

Having established their association, it then remains open for A to acquire B's shareholding in C without making a formal takeover offer. In this case it may be useful to extend Section 732 ("unacceptable conduct") to clearly apply to associations that are "manufactured" to enable a circumvention of the rules in Chapter 6.

DOWNSTREAM ACQUISITIONS

The Institute supports recommendation 19 of the Legal Committee of CASAC (Anomalies in the Takeover Provisions of the Corporations Law, March 1994 Report) except where the acquisition of the upstream company has as its significant purpose acquisition of the downstream entity. The Panel would have the discretion to decide whether such a purpose (unacceptable conduct) existed.

INDUCEMENTS DURING OFFER

Section 698 (1) prevents a bidder giving a target company shareholder an inducement/benefit during the period of the takeover offer unless such inducement/benefit is offered to all shareholders. In its current form, this sub-section would catch all benefits given, whether in connection with the takeover offer or in the ordinary course of business.

In the 1994 Federal Court case of Gantry Acquisition Corp v Parker & Parsley Petroleum Australia, the Full Court held that Section 698 referred to benefits provided to shareholders in their capacity as shareholders. In that case, the court decided that benefits provided to executives in their capacity as employees did not contravene Section 698.

Sections 698 (1) and (3) should therefore be amended to reflect the common law position that only benefits provided to target shareholders in their capacity as owners of shares should be caught by Section 698. With this amendment, it will be clear that a benefit given in the ordinary course or unrelated to the takeover offer is expressly excluded from the operation of this Section.

Inducements prior to offer

The application of Section 698 (2) has been the source of a number of problems. The Queensland Court of Appeal in Sagasco gave a wide interpretation to the references to "any benefit" in Sections 698 (2) and (4). This interpretation may result in an off-market acquisition prior to an offer contravening the law not because a higher price is received but because the vendor received an immediate cash payment.

Fortunately, a majority of the High Court concluded that "mere earlier payment" would not constitute a benefit for the purposes of Section 698 (2) and (4). However, the case has left open the possibility that a subsequent conditional offer or scrip offer will trigger the application of Section 698 (2) in relation to pre-bid acquisitions of shares.

The Subcommittee calls for the repeal of...
Section 698 (2) and (4). Chapter 6 is concerned with the regulation of share acquisitions where, as a result of such acquisitions, a party’s entitlement exceeds the 20% threshold. It is inappropriate that the legislation has been extended to restrict acquisitions up to the 20% entitlement. As an alternative, the Subcommittee suggests that Section 641 be amended to ensure that extra benefits provided to shareholders, in their capacity as shareholders, be included in the calculation of the “highest price per share paid” during the four months leading up to the dispatch of an offer.

SECTION 627 LOOPHOLE
Companies have used Section 627 to gain control of targets without a full offer being made to all of the target’s shareholders. In the illustration contained in Appendix D, company A wants to gain control of company B. Company B’s capitalisation consists of 100 shares and 50 convertible notes (which can be converted at any time). For the sake of the example, we have assumed that shareholders would accept an offer of $1.00 per share. On the other hand, A has only $70 in spending capacity and wants to move quickly. Further, company B has a single major shareholder with 20% (which is a private company).

There are two loopholes available for company A to gain control of B without a full offer being made to all shareholders.

Firstly, company A buys the private company with the 20% holding in B. It buys the shares in the private company at a price which implies a price per B share of $1.00.

By using this technique, company A has avoided the requirement of Section 641 which states that any takeover offer must be made at a price at least as high as any price paid for shares in the target during the last four months. Because company A has not bought any shares in the target – but rather, bought shares in an interposed private company – it avoids Section 641.

Company A may then launch an unconditional bid for B at a deliberately low price of, say $0.75 per share. The bidder then announces that it will stand in the market for B’s convertible notes at $1.00 per note. Although conversion of convertible notes would normally be treated in the same way as any acquisition of shares Section 627 provides for conversion unhindered by Chapter 6 if the convertible note was acquired at the same time as the unconditional takeover offer. If A’s offer for convertible notes is successful, A would then have achieved control of 70 shares or 47% of B’s expanded capital.

One of the difficulties in eliminating this anomaly under Section 627 is the determination of an equivalent value between convertible notes/options and ordinary shares. Rather than be prescriptive, the Subcommittee would recommend that such cases be referred to the Panel (where there is a dispute) to determine whether “unacceptable conduct” exists.

PART C OFFERS
Is the legislation dealing with “takeover announcements” or Part C offers necessary? If a bidder wishes to stand in the market and acquire shares it is free to do so under the Part A provisions. Removal of the provisions relating to Part C offers would reduce the complexity of Chapter 6 by eliminating the unjustifiable anomalies that exist between Part A and Part C offers. Takeover schemes provide bidders with the greatest flexibility – allowing for conditional offers, partial offers, cash consideration, cash and scrip, etc. It is sensible to remove the provisions relating to Part C offers.

The more significant (and illogical) anomalies between Part A and Part C offers include:

- An offeror has more flexibility in regard to timing with the takeover offer than a takeover announcement. Following lodging of the Part A, the offeror has up to 28 days to dispatch offers; with a Part C the offeror must commence buying precisely 14 days after serving of the Part C (Sections 637 and 674).
- A Part A must be registered, whilst the Part C needs only to be lodged with the Stock Exchange and the ASC.
- A Part A offer can contain conditions relating to “prescribed occurrences”, even in circumstances where purchases of shares on-market are permitted. A Part C offer must be unconditional (Section 620).
- An on-market offeror cannot increase its price during the last five trading days of the Part C offer (Section 677). Conversely, there are no restrictions as to a Part A offeror increasing its offer, even at the last moment (which itself is a major anomaly).
- An unconditional Part A offeror can extend its offer pursuant to Section 656, at any time up until the last moment. An on-market offer can only be extended with a minimum of five day’s notice.
- Although provisions are made for price increases to be made in both takeover offers and announcements, significant differences exist in each case:
  - Where a Part A offeror decides to make a formal increase in the price it is required to make similar variations to all offers that have not yet been accepted and to vary the consideration specified under a contract arising from an acceptance that has already been made. Such variations must be notified to all shareholders and registration with the Commission of such notice (Section 659).
  - In the case of Part C offers an increase in price is permitted. However, if such an increase is made, it does not have to be extended to shareholders who have already accepted, and no notification to shareholders or the Commission is required. On the other hand, an increase in the Part C offer price cannot be made during the last five trading days of the offer, whereas an increase in a Part A price can be made at any time.

The argument most often used in favour of the retention of Part C offers is that the removal of this option limits a bidder’s flexibility to make a clean and simple on-market cash bid. This argument seemingly ignores the ability of a Part A offeror to acquire shares on the market free of any conditions with consideration payable immediately. Accordingly, it would still be possible to make on-market offers which resemble the present Part C offer in every significant respect.

**IRREVOCABLE UNDERTAKINGS**

The Subcommittee queries why irrevocable undertakings from shareholders prior to the dispatch of a Part A or Part C should not be permitted. In the United Kingdom, a potential bidder is permitted to obtain irrevocable undertakings from shareholders that they will accept a bid at a set price within a set time period, unless a higher offer is made. This is not permitted in Australia where the combined entitlement arising from such undertakings, together with the bidder’s holding, would exceed 20%. Such undertakings are facilitative of bids but do not infringe the Eggleston principles.

**MISCELLANEOUS ISSUES**

**Variations and extensions**

Increases in the consideration offered under a Part A offer should be treated in the same way as variations or extensions under a Part C offer. The opportunity for a Part A offeror to increase its bid on the last day of the offer to gain acceptances from a small number of substantial shareholders is contrary to the fourth Eggleston principle of equality of treatment for all shareholders. We suggest that either no increases can occur in the last five days or should an offeror increase their bid on the last day, that the offer is automatically extended for another five business days.

For conditional offers, the Subcommittee would recommend that offerors can, in the event of a counter offer in the last five days, increase their bid. This recommendation would be subject to the bid then being automatically extended for another five business days.

**Disposals during bids**

Section 686 prevents an offeror from disposing of shares in a target company during the takeover period, except in circumstances where an offeror disposes of its shares in the target, a subsidiary (or an associate of the offeror) of the offeror. The Subcommittee considers that the enforcement of Section 686 should be extended to situations where an associate of the offeror disposes of its shares in the target, otherwise than by acceptance of the takeover offer. Any other disposal by an associate of the offeror may result in a reduction in the offeror’s entitlement and would clearly be contrary to the spirit of Section 686.

In addition, it facilitates “sham” transactions where an associate deliberately sells on-market to artificially lower the share price of the target and thereby increase the likelihood of the offeror’s original bid price succeeding.

The corollary to this amendment should be the inclusion of an “associate” concept for the acquisition of shares during the currency of the takeover offer. As presently drafted, Section 677 relates only to acquisitions by the offeror. Accordingly, there is nothing to prevent an associate of the offeror acquiring target shares at a higher price without that higher price then having to be offered to all target shareholders. In the context of a Part A scrip offer, it may be possible for an associate of the bidder to acquire shares on-market without a cash alternative then having to be offered to all target shareholders.

**Directors’ dealings in shares**

Under the current First Corporate Law Simplification Bill, directors are given 14 days within which to notify the Stock Exchange of any change in their shareholding of a listed company. The Institute’s preferred position is that directors should notify the Stock Exchange within two business days, the same requirement as for substantial shareholders.

A short period is especially important once a takeover has been announced. We suggest the period be reduced from 14 days once a Part A or Part C document has been served. In the context of a bid we believe the information should be given by a director by 9.30am on the day after the dealing. This is the requirement imposed on a bidder and on other substantial shareholders during a bid. Information about directors’ dealing is of no less importance. This is especially so if the directors or their associates are dealing in shares.
Appendix A: A seeking to gain control of B

- A has a relevant interest in D’s 35% stake in B
- Therefore, A can acquire these shares without breaching Chapter 6

Appendix C: Becoming Associated

Appendix B: Prohibited acquisition which should be legal. Can A buy a further 5% of C?

Appendix D: Use of convertible notes or options to gain control of a company

Company B has 100 shares on issue. 50 convertible notes on issue notes can be converted at any time shareholders would accept an offer of $1.

Company A wants control, only has $70 in spending capacity wants to move quickly.