

**Legal Committee
of the
Companies and Securities
Advisory Committee**

**Compulsory Acquisitions
Report**

January 1996

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Preparation of the Report

1.1 This Report has been prepared by the Legal Committee of the Companies and Securities Advisory Committee for publication by the Advisory Committee. The Legal Committee provides expert analysis, assessment and advice to the Advisory Committee in relation to matters referred to it by that Committee in connection with:

- (a) a proposal to make or amend a national scheme law;
- (b) the operation or administration of a national scheme law;
- (c) law reform in relation to a national scheme law;
- (d) companies, securities or the futures industry; or
- (e) a proposal for improving the efficiency of the securities markets or futures markets.

Advisory Committee

1.2 The members are:

David Hoare (Convenor), Chairman - Bankers Trust Australia Ltd, Sydney

Reg Barrett, Partner - Mallesons Stephen Jaques, Sydney

Philip Brown, Professor of Accounting - University of Western Australia, Perth

Alan Cameron, Chairman - Australian Securities Commission

David Crawford, Chairman - KPMG Peat Marwick, Melbourne

Kevin Driscoll CBE, Chairman - National Homes Pty Ltd, Brisbane

Patricia Faulkner, Director - KPMG Management Consulting, Melbourne

Leigh Hall, Deputy Managing Director - AMP Investments Australia Ltd, Sydney

Patricia Khor, Securities Advisor - Johnson Taylor, Stock Brokers & Financial Planners

Wayne Lonergan, Partner - Coopers & Lybrand, Sydney

Ann McCallum, Audit Partner - Garraway & Partners, Darwin

Alan McGregor AO, Chairman - FH Faulding & Co Ltd, Adelaide
 Mark Rayner, Chairman - Pasmenco Ltd, Melbourne
 John Story, Managing Partner - Corrs Chambers Westgarth, Brisbane.

Legal Committee

1.3 The members at the time the Legal Committee settled this Report were:

Reg Barrett (Convenor), Partner - Mallesons Stephen Jaques, Sydney
 Tony Abbott, Managing Partner - Piper Alderman, Adelaide
 Michelle D'Adamo, Partner - Clayton Utz, Perth
 Ian Briggs, Partner - Minter Ellison Morris Fletcher, Brisbane
 Brett Heading, Partner - McCullough Robertson, Brisbane
 Geoff Hone, Partner - Blake Dawson Waldron, Melbourne
 Wendy Peter, Partner - Arthur Robinson & Hedderwicks, Melbourne
 Jillian Segal, Consultant - Allen Allen & Hemsley, Sydney
 Laurie Shervington, Partner - Minter Ellison Northmore Hale, Perth
 Valentine Smith, Partner - Dobson Mitchell & Allport, Hobart
 Malcolm Starr, Policy Director, Government & Legislative Affairs - Sydney Futures Exchange, Sydney
 Anne Trimmer, Partner - Deacons Graham & James, Canberra
 Gary Watts, Partner - Fisher Jeffries, Adelaide
 Nerolie Withnall, Partner - Minter Ellison Morris Fletcher, Brisbane.

Advisory Committee Executive

1.4 Members of the Executive involved in preparing this Report are:

John Kluver - Executive Director
 Vincent Jewell - Deputy Director
 Thaumani Parrino - Executive Assistant.

Background to the Report

1.5 In March 1994, the Legal Committee published an Issues Paper on Compulsory Acquisitions. This Paper identified a broad range of policy and procedural issues and options for reform arising from the various compulsory acquisition and buy-out¹ powers in the Corporations Law, namely:

- acquisitions following on from a successful Chapter 6 bid: s 701
- buy-outs: s 703
- share acquisitions under s 414
- selective capital reductions: s 195
- amendment of articles of association: s 176
- schemes of arrangement: s 411
- amalgamations: s 413
- selective share buy-backs
- voluntary liquidations and selective distribution in specie: s 501
- voluntary liquidations - amalgamation: s 507
- sale of assets and liquidation.

1.6 In November 1994, the Legal Committee circulated a further Paper setting out a proposed new compulsory acquisition power.

1.7 A list of respondents to these Papers is set out in Appendix 1 of this Report.

Overview of the Report

1.8 In this Report, the Legal Committee recommends reforms to some of the methods of compulsory acquisition and buy-out identified in the Issues Paper. Some key recommendations are to:

¹ A buy-out is where the holder of securities can require their purchase by another person.

- confine the High Court decision in *Gambotto v WCP Ltd*² (*Gambotto*) to compulsory acquisitions through amending articles of association
- permit Chapter 6 bids for, and apply s 701 to, any class of securities (not only shares as at present)
- extend s 701 to all securities of a bid class
- reform the compulsory acquisition threshold in s 701 by maintaining the 90% total entitlement test, but replacing the 75% in number tests with a 75% outstanding entitlement test
- permit the court, as well as the ASC, to relax the compulsory acquisition threshold in s 701 where appropriate
- confine buy-outs under s 703 to bid class securities and securities that are convertible into bid class securities
- repeal s 414 or, if the section is retained contrary to the Legal Committee's recommendation, apply the same compulsory acquisition threshold as in s 701
- create a new power to permit a 90% full beneficial interest holder of any class of securities to compulsorily acquire the remaining securities of that class. The procedure will require court approval of the offer price where a minimum number of remaining holders dissent
- introduce specific fair value tests for securities to be acquired under s 701 or the new procedure.

The full list of recommended reforms to the existing provisions is set out in Appendix 2. The proposed new compulsory acquisition power is set out at paras 10.1 ff of this Report.

1.9 The Legal Committee does not recommend any reform to compulsory acquisitions or buy-outs through:

- selective capital reductions
- selective share buy-backs, or
- amending articles of association.

² (1995) 128 CLR 432; 127 ALR 417.

1.10 The procedures governing share buy-backs have recently been changed after extensive public consultation.³ The rules for share capital reductions are currently being reviewed in the Corporations Law Simplification Program. The Legal Committee considers that any consequential changes to these rules should not permit selective capital reductions to be used for compulsory acquisitions in any manner that could reduce the protections otherwise available under the existing compulsory acquisition provisions (as proposed to be amended in this Report) or under the proposed new compulsory acquisition procedure. The High Court in *Gambotto* has dealt with the alteration of articles of association for the purpose of compulsory acquisition. The Legal Committee does not propose any reform of the rules governing the amendment of articles.

Benefits of compulsory acquisition

1.11 The Legal Committee considers that compulsory acquisitions can be a necessary and desirable means of corporate rationalisation. They may produce considerable economic, administrative and taxation benefits⁴ including:

³ The First Corporate Law Simplification Act 1995 reformed the law of share buy-backs in Pt 2.4, Div 4B.

⁴ For instance, in *Elkington v Shell Australia* (1992) 10 ACSR 568 at 569-70, McLelland J stated that the policy behind compulsory acquisitions under s 701 "must be considered against the background of the economic advantages which may in broad terms be perceived as flowing from the amalgamation of business enterprises, and the financial, administrative and commercial advantages which accrue from one company becoming a wholly owned subsidiary of another". These advantages were identified by the NSW Court of Appeal in *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 587, 590. In *WCP Ltd v Gambotto* (1993) 10 ACSR 468, the NSW Court of Appeal acknowledged that full ownership would result in "enormous taxation advantages" by permitting the transfer of tax losses between fully owned companies in a corporate group (ITAA s 80G) and "considerable administrative savings" by avoiding the company having to prepare audited group accounts. The advantages of compulsory acquisitions are also summarised in Q Digby, *Eliminating Minority Shareholdings* (1992) 10 C&SLJ 105 at 107-8, IR Renard & JG Santamaria, *Takeovers and Reconstructions in Australia* (Butterworths) at [1201], and D

- facilitating financial restructuring
- permitting the transfer of tax losses between wholly owned grouped companies
- reducing administrative and reporting costs
- avoiding greenmailing
- protecting the confidentiality of commercial information and otherwise eliminating possible conflicts of interest in partially owned companies.

1.12 Compulsory acquisitions also involve the extinction of property rights in the company. The legitimate interests of minorities therefore need to be recognised and protected.

Regulatory goals

1.13 The Legal Committee took the view in its Issues Paper that compulsory acquisitions are an appropriate and accepted feature of Australian commerce, notwithstanding that they override the proprietary rights of individual shareholders. The regulatory objective was to balance the interests of all shareholders, to avoid either minority oppression or minority dictation. In principle this required:

- full disclosure of all material facts relevant to the proposed compulsory acquisition
- fair treatment of persons affected by the expropriation, and
- adequate external scrutiny by the courts or the ASC.

1.14 The Legal Committee also stated in the Issues Paper that in some respects the existing compulsory acquisition provisions may be too restrictive, particularly in regard to the prerequisites for compulsory acquisition under s 701. They could be relaxed without compromising the goals of equity and fairness.

Submissions

Grave, *Compulsory Share Acquisitions: Practical and Policy Considerations* (1994) 12 C&SLJ 240 at 241.

1.15 Submissions generally supported the regulatory goals formulated by the Legal Committee.

1.16 The Securities Institute of Australia (SIA) said that compulsory acquisition should be sanctioned as an acceptable part of the corporate law. The Australian Securities Commission (ASC) considered that the aim of reviewing the available procedures for compulsory acquisition should be to secure fairness for minority shareholders rather than to discourage these acquisitions.

1.17 The Australian Institute of Company Directors (AICD) strongly endorsed the Legal Committee's statement of regulatory goals. The Business Law Section of the Law Council of Australia (the Law Council) also supported the regulatory objectives identified in the Issues Paper. It considered that compulsory acquisitions should be permitted where the majority shareholding is overwhelming in size and the terms and processes of compulsory acquisition are evidently fair.

Legal Committee response

1.18 The Legal Committee endorses the regulatory objectives identified in the Issues Paper of full disclosure and fair treatment in compulsory acquisitions. Where necessary, the courts or the ASC should have an appropriate supervisory role.

Implications of *Gambotto v WCP Ltd*

The decision

1.19 After the Legal Committee published its Issues Paper, the High Court handed down the decision in *Gambotto*. This case concerned an attempt to compulsorily acquire minority shares by amending a company's articles of association under s 176 to permit the expropriation. The High Court ruled that any such amendment was improper, except with the consent of all

shareholders or in other limited circumstances.⁵ In *Gambotto*, the attempted amendment was ruled invalid.

1.20 The High Court decision has imposed substantial proper purpose, procedural and substantive fairness requirements on the use of s 176 to expropriate minority holdings. The Legal Committee does not propose any additional or substituted requirements for that section.

Submissions

1.21 The Law Council submitted that *Gambotto* has potentially adverse implications for the specific compulsory acquisition powers in the Corporations Law, in particular ss 414 and 701. In the Law Council's view, "that decision adds to the urgency of providing clear and specific legislative guidance to the Courts as to the principles and procedures under which compulsory acquisition is appropriate. Unless this is done, the resulting legal uncertainty and likely protracted litigation may become major obstacles to the efficient and fair operation of Australian securities markets". The Law Council also considered that "if a powerful new disincentive to takeovers results from the *Gambotto* doctrines, prices for Australian shares could well be generally depressed and the shares could become less readily tradeable".

1.22 The Law Council submission was principally concerned with three possible outcomes from the *Gambotto* decision:

- imposing a "proper purpose" requirement in s 414
- reversing the onus on dissidents under s 414 or s 701
- introducing additional disclosure obligations in s 701.

⁵ The High Court majority, comprising Mason CJ, Brennan, Deane and Dawson JJ, held that articles could be altered to permit expropriation of minority shares only "where it is reasonably apprehended that the continued shareholding of the minority is detrimental to the company, its undertaking or the conduct of its affairs - resulting in detriment to the interests of the existing shareholders generally - and expropriation is a reasonable means of eliminating or mitigating that detriment" (127 ALR at 425).

1.23 The Law Council pointed out that the majority decision in *Gambotto* cited an authority⁶ which indicated that even compulsory acquisitions under s 414 must be shown to be for a good reason. This authority contrasts with the previously prevailing view that s 414 was a structural section designed to facilitate amalgamations and mergers. The Law Council opposed any additional "proper purpose" restriction on the use of the s 414 power.

1.24 The Law Council expressed concern that the reasoning of the High Court might support a reversal of the onus previously resting on dissenters under s 414 or s 701.⁷ In its view, this reversal "would greatly protract litigation and delay the economic and commercial benefits flowing from 100% ownership". Also, "dissenters will use the threat of protracted and uncertain litigation to extract an additional compulsory acquisition premium".

1.25 The Law Council stated that, based on the *Gambotto* reasoning, "it could be argued that the disclosures made in the Pt A and C Statement need to be refreshed and updated at the compulsory acquisition stage". The Law Council pointed out that the courts had recently emphasised the very onerous disclosure obligations associated with the conduct of a takeover scheme under Chapter 6.⁸ In its view, "the imposition of additional disclosure requirements at the compulsory acquisition stage provides a powerful incentive against takeover activity generally, given that many offerors wish to gain the benefits of 100% ownership". The Law Council also pointed out that any "comprehensive new requirements to obtain a full independent valuation at compulsory acquisition stages of a takeover would be very onerous and expensive".

⁶ *Re Bugle Press Ltd* [1961] Ch 270.

⁷ *Eddy v WR Carpenter Holdings Ltd* (1985) 10 ACLR 316 at 318.

⁸ *Pancontinental Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463, *Gantry Acquisition Corporation v Parker & Parsley Petroleum Australia Pty Ltd* (1994) 14 ACSR 11.

Legal Committee response

1.26 The Legal Committee considers that, in the context of compulsory acquisitions, the *Gambotto* principles should be confined to s 176. They should not be applied in a manner that restricts the compulsory acquisition powers in s 414 (if retained) or s 701.

Recommendation 1: Sections 414 (if retained) and 701 should be amended to put beyond doubt that:

- . they are not subject to any "proper purpose" limitation⁹*
- . the onus remains on dissidents.¹⁰*

It should be made clear that no disclosure additional to the Part A and Part C Statements should be required under s 701.

Current powers

Acquisitions following a successful Chapter 6 bid: s 701

Outline of s 701

2.1 A bidder may employ the compulsory acquisition power under s 701 where in consequence of a full takeover bid for voting or non-voting shares¹¹ the bidder has, during the takeover period, become entitled to not less than 90%, by value, of shares in the class to which the offer relates. In addition, where a bidder starts with an entitlement to more than 10% of the shares:

⁹ See also Recommendation 12, post.

¹⁰ See also Recommendation 13, post, in regard to the onus under s 701 remaining on dissidents.

¹¹ A bidder may use the Chapter 6 procedure to acquire non-voting shares and thereby obtain the benefits of s 701. No ASC modifications are required: ASC Practice Note 8.

- 75% or more of the offerees must have disposed of their shares to the offeror, or
- 75% or more of the registered holders must no longer be registered as members within one month of the close of the bid.

2.2 A bidder who chooses to exercise the compulsory acquisition powers has two months from the end of the offer period to give notices in the prescribed form to all non-accepting shareholders.¹² The remaining shares must be acquired on the same terms as applied to the successful bid. Dissenting offerees may seek a court order that their shares not be compulsorily acquired.

Securities other than shares

2.3 The Chapter 6 bid, and s 701 compulsory acquisition, procedures can be used for any class of voting or non-voting shares.¹³ However, a successful bidder for these shares cannot compulsorily acquire other classes of securities, including options over, or convertible notes for, the bid class of shares.¹⁴ The Legal Committee supports this restriction as:

¹² The Legal Committee assumes that s 701(2) requires any compulsory acquisition offer to be made to all remaining shareholders, notwithstanding that the subsection refers to an offeror giving notice "to a dissenting offeree".

¹³ Non-voting shares can be made subject to a Chapter 6 offer: ASC Practice Note 8. Also, as Renard & Santamaria point out, supra note 4 at [1215], it would theoretically be possible for the ASC to exercise its powers under s 730 to permit compulsory acquisition of non-voting shares under s 701, based, for instance, on the success of any prior takeover bid for the voting shares.

¹⁴ In *ANZ Executors & Trustees Ltd v Humes Ltd* (1989) 15 ACLR 392, a company requested the NCSC to exercise its discretion under the equivalent of s 730 to enable it to compulsorily acquire convertible notes. The court ruled (at 414) that the Commission did not have the power to modify the equivalent of s 701 in the way requested. Renard & Santamaria, supra note 4 at [1215], also point out that the matters in s 731 that the ASC must take into account for the purposes of s 728 or s 730 only relate to issued voting or non-voting shares. This contrasts with the UK legislation which permits an offeror to compulsorily acquire convertible securities: UK Companies Act 1985 s 430F.

- these other securities may have a much higher market value than the bid class shares
- the number of convertible securities could be a substantial proportion of, or even exceed, the number of issued shares in the bid class, thereby permitting a successful bidder for a class of issued shares to compulsorily acquire a large number of these convertible securities.¹⁵

2.4 The Legal Committee recognises that this restriction on the compulsory acquisition of non-bid class securities could prevent a successful bidder from gaining complete control of the target company. In response, the Legal Committee recommends that the Chapter 6 procedure, including compulsory acquisition, should be available (though not obligatory¹⁶) for any other class of securities, including options and convertible notes. However, each bid, and the exercise of the s 701 compulsory acquisition power, should be on a class by class basis, with options and convertible notes being treated as separate classes. The Simplification Task Force might consider possible modifications to Chapter 6 to facilitate bids for any class of securities.¹⁷

Recommendation 2: A person should be entitled to conduct a separate Chapter 6 takeover bid for any class of securities. The compulsory acquisition power under s 701 should apply only to the securities of the bid class.

2.5 The following analysis of s 701 reflects its current application only to shares. However, given Recommendation 2, the Legal Committee recommendations for other reform of s 701 will refer to securities, rather than being confined to shares.

Bid class shares excluded from compulsory acquisition

¹⁵ This covers the matters dealt with in Issues 23-25 and 27 of the Issues Paper.

¹⁶ The Legal Committee does not propose any change to the restrictions on acquisitions under s 615 which apply only to voting shares.

¹⁷ See, for instance, note 14, supra.

2.6 Currently, two categories of bid class shares cannot be compulsorily acquired:

- shares to which the bidder is entitled at the outset of the bid
- shares in the bid class issued after the making of the bid (later issued shares).

Initial entitlement

2.7 Shares to which a bidder is entitled at the outset of the bid are excluded from compulsory acquisition.¹⁸ This includes shares held by any associate of the bidder at the commencement of the bid,¹⁹ regardless of whether, during the bid:

- the bidder has any real control over those shares²⁰
- the association continues, or
- the associate retains the shares or sells them to a third party.

Issue: Should shares to which an offeror is entitled at the outset of the bid be subject to compulsory acquisition under s 701?

Submissions

2.8 The submissions supported these shares being subject to compulsory acquisition.

2.9 Various submissions pointed out that it was not uncommon for a bidder to have an "entitlement" to voting shares over which

¹⁸ Paragraph 701(1)(a) excludes from compulsory acquisition "shares to which the offeror was entitled when the first of the offers was made".

¹⁹ Under s 609(1)(b), an offeror is entitled to any shares in which an associate has a relevant interest.

²⁰ For instance s 11 designates certain persons, including any director or secretary of a related body corporate (defined under s 50), as associates of the body corporate. A bidder may have little or no control over shares held, say, by an independent director of a related body corporate, yet it will be unable to compulsorily acquire them because of the exclusionary effect of the words in parentheses in s 701(1)(a).

it exercised no real control.²¹ The SIA considered it anomalous that a bidder must dispatch offers to all shareholders (including associates), but that offerees who are associates at the outset of the bid are excluded from compulsory acquisition under s 701. Another submission supported this power being at the option of the offeror, given that it might not suit the offeror, for stamp duty or tax reasons, to be forced to acquire the shares held by its associates.²²

Legal Committee response

2.10 The Legal Committee considers that an offeror who satisfies the compulsory acquisition threshold should have the option to compulsorily acquire any securities of the bid class to which it was entitled at the outset of the bid. This would include securities in which it had only a deemed interest under s 33.²³ A bidder who chooses to exercise that option must give compulsory acquisition notices to all holders of these securities, except for those held either by itself or by a related corporation.

Recommendation 3: Securities of the bid class to which an offeror is entitled at the outset of the bid should be subject to compulsory acquisition under s 701, at the option of the offeror. Any compulsory acquisition notice must be sent to all holders of these securities, except for those held by the offeror or any related corporation.

Later issued shares

²¹ Law Council *Submission*; Corrs Chambers Westgarth *Submission* (Corrs *Submission*).

²² Rosenblum & Partners *Submission* (Rosenblum *Submission*).

²³ Recommendation 6, post, excludes securities of a bid class in which an offeror only has a deemed interest under s 33 in determining and satisfying the compulsory acquisition threshold. If the threshold, as proposed in Recommendation 7 post, is otherwise satisfied, Recommendation 3 will then permit the offeror to compulsorily acquire all remaining securities of the bid class, including those to which it is entitled only under s 33.

2.11 A s 701(2) notice entitles and binds a bidder under a Part A offer to acquire "the shares in respect of which the offers were made", excluding shares to which the bidder was already entitled when the first offers were made.²⁴ The Legal Committee has elsewhere recommended that a bidder have some discretion to settle the date for determining which shares are subject to the offer and therefore may be compulsorily acquired.²⁵ Nevertheless, shares of the same class as those subject to a Part A offer, but issued after that date (later issued shares), cannot be compulsorily acquired under s 701, even though they may be indistinguishable from earlier issued shares and may be impossible to separately identify once they are traded on the ASX. Later issued shares under a Part C announcement can be compulsorily acquired.²⁶

Issue: Should later issued shares of the bid class be subject to compulsory acquisition?

Submissions

2.12 The submissions supported later issued shares being subject to compulsory acquisition.

2.13 The ASC submitted that without this reform a successful bidder may not be able to obtain full ownership. This creates an artificial distinction between shareholders whose rights are subordinate to the rights of the majority shareholder and shareholders whose rights are not affected.

2.14 Other submissions supported the suggested reform. It would discourage target companies from issuing shares after the bid commenced merely to prevent the bidder from achieving full

²⁴ The offeror may compulsorily acquire "outstanding shares" held by non-accepting offerees (s 701(2)). "Outstanding shares" are defined as "shares subject to acquisition" (s 701(1)(c)), which, in turn, are defined as "the shares in respect of which offers were made", excluding "shares to which the offeror was entitled when the first of the offers was made" (s 701(1)(a)).

²⁵ Legal Committee Report: *Anomalies in the Takeovers Provisions of the Corporations Law*, 1994, Recommendations 22-23.

²⁶ s 701(1)(b).

control. The SIA saw no policy grounds for excluding later issued shares. Not to include them would undermine the compulsory acquisition provisions.

2.15 The Law Council supported the inclusion of later issued shares. If the relevant thresholds are achieved, the offeror should be entitled to acquire all shares in the relevant class.

Legal Committee response

2.16 The Legal Committee supports a bidder having the option to compulsorily acquire all later issued securities of the bid class which are issued before the first s 701(2) notice for the bid class securities, provided:

- the compulsory acquisition threshold test is still satisfied, taking all these later issued securities into account²⁷
- all later issued securities of the bid class are compulsorily acquired. All holders of these securities should be treated equally.

These principles should apply to Part A offers and Part C announcements.

Recommendation 4: An offeror under a Part A offer or Part C announcement should have the option to compulsorily acquire all later issued securities of the bid class that are issued prior to the first s 701(2) notice, provided that the compulsory acquisition threshold is satisfied for all issued securities of that class, including those later issued securities.

²⁷ See Recommendation 7 and note 69, post.

90% or greater entitlement

2.17 A bidder who is already entitled to 90% or more of the voting shares cannot make a further Chapter 6 bid and use s 701 to compulsorily acquire the remaining voting shares unless the ASC exercises its discretion under s 730 to modify Chapter 6.²⁸

Issue: Should the legislation permit a bidder who is already entitled to 90% or more of a company's voting shares to conduct a Chapter 6 bid and exercise the compulsory acquisition powers under s 701?

Submissions

2.18 The submissions generally supported such a bidder being able to conduct a takeover bid and exercise the compulsory acquisition powers.

2.19 The SIA said that these bidders have to resort to other means of compulsory acquisition which may not provide equivalent protection to dissenting offerees. The ASC pointed out that it may use its modification power to allow the use of s 701 on a discretionary basis. However, the Commission preferred that the legislation expressly permit these bids.

Legal Committee response

2.20 The Legal Committee supports Chapter 6 and the compulsory acquisition provisions being available for a bidder with an initial entitlement of 90% or more of the bid class securities. It elsewhere recommends a new method of determining the compulsory acquisition threshold for Chapter 6 bids.²⁹ This will ensure that a bidder whose initial entitlement is 90% or more cannot exercise the compulsory acquisition powers under s 701 unless the bid has been accepted by at least 75% (by value) of the remaining holders.³⁰

²⁸ ASC Practice Note 8 para 4.

²⁹ Recommendation 7.

³⁰ Taking into account Recommendation 7 and note 69 post, a bidder with an initial entitlement of 90% would have a compulsory acquisition

Recommendation 5: A bidder who is already entitled to 90% or more of a class of securities should be entitled to conduct a Chapter 6 bid and exercise the compulsory acquisition powers under s 701 for that class of securities.

Deemed entitlement

2.21 The ASC has argued that, in some circumstances, an offeror could artificially rely on deemed entitlements under s 33³¹ to help satisfy the compulsory acquisition threshold. The ASC proposed that entitlements under s 33 be disregarded for that purpose.

2.22 The notion of deemed entitlement could give an offeror an advantage in reaching the compulsory acquisition threshold.³² This could be overcome by disregarding any entitlement that arises *only* under s 33.³³

threshold of 97.5% of the total bid class securities. A bidder with an initial entitlement of 95% would have a compulsory acquisition threshold of 98.75%.

³¹ The ASC gave as an example of deemed entitlement under s 33 a target company (T) holding 20% of the voting shares in another company (A) which, in turn, holds voting shares in T. If the offeror acquires more than 50% of the voting shares (and thus a "controlling interest") in T during a bid then, under ss 32 and 33, the offeror obtains a relevant interest in, and thus under s 609(1)(a) an entitlement to, the voting shares in T held by A, even if A is hostile to the bid.

³² For instance, assume that a company has 1 million issued voting shares, of which the offeror holds, say, 100,000 (10%) in its own right. However, by virtue of s 33, the offeror also has a deemed entitlement to, say, a further 400,000 of those shares. The offeror must make offers for those 400,000 shares (s 636(2)). However, it is not necessary for the offeror to receive any acceptances to count them in determining whether it has reached the compulsory acquisition threshold.

³³ Applying this approach to the example in note 32, the offeror could not count any of the 400,000 shares for the purpose of satisfying the compulsory acquisition threshold except for those to which it obtained an entitlement other than under s 33, for instance, by the holder(s) of those shares accepting the bid.

Issue: Should shares in which an offeror has a deemed interest under s 33 be disregarded for the purpose of satisfying the compulsory acquisition threshold?

Submissions

2.23 The submissions generally supported these shares being disregarded, as they create artificial interests in many circumstances.

2.24 The SIA's support was conditional on s 33 being amended as recommended in the March 1994 Legal Committee Report on Takeover Anomalies.³⁴

2.25 One submission argued against disregarding those shares.³⁵ It submitted that it would be illogical to count the shares in which the offeror has a deemed relevant interest under s 33 in determining whether an offeror has breached the 20% threshold under s 615, but disregard them for the purposes of s 701(2)(b). The Legal Committee disagrees, as the 20% and 90% thresholds perform quite different functions and need not necessarily adopt identical entitlement tests.³⁶

Legal Committee response

2.26 The Legal Committee elsewhere recommends a new method for determining the compulsory acquisition threshold for each Chapter 6 bid.³⁷ It considers that securities of a bid class to which an offeror has only a deemed entitlement under s 33 should be excluded in determining the offeror's initial entitlement, and

³⁴ Legal Committee Report: *Anomalies in the Takeovers Provisions of the Corporations Law*, 1994, Recommendations 1-3.

³⁵ Rosenblum *Submission*.

³⁶ The role of s 33 in relation to s 615 (the 20% threshold) is to counter possible "warehousing" of interests in shares through the interposition of other entities. A shareholder's entitlement must include shares in which it has a deemed relevant interest under s 33. By contrast, the current s 33 may permit an offeror to rely on an artificial deemed entitlement to satisfy the compulsory acquisition threshold.

³⁷ Recommendation 7.

therefore the compulsory acquisition threshold,³⁸ and whether that threshold has been satisfied.³⁹ The offeror would need to have some other entitlement to them, for instance by the holder(s) of those securities accepting the bid.

Recommendation 6: Securities of a bid class in which an offeror only has a deemed interest under s 33 should be excluded for the purpose of determining its initial entitlement and whether the compulsory acquisition threshold has been satisfied.

Compulsory acquisition threshold

2.27 The rationale of s 701 is that a bidder's right to compulsorily acquire remaining shares on the same terms as under the offer, and casting the onus on dissidents to challenge that right in relation to their own shares, should only arise where an offer has been overwhelmingly accepted by offeree shareholders. Two tests are used to determine overwhelming acceptance:

- . the 90% entitlement test,⁴⁰ and
- . the 75% in number tests.⁴¹

Ninety per cent entitlement test

2.28 In principle, two distinct 90% entitlement tests are possible:

³⁸ As explained in note 69, the effect of Recommendation 7, post, is that the compulsory acquisition threshold will increase beyond 90% for any bidder with an initial entitlement of more than 60%.

³⁹ Assume, for instance, that an offeror has an initial entitlement of 80% of the bid class, of which 10% is a deemed entitlement under s 33. Applying the deemed entitlement exclusion, the offeror's initial entitlement for the purpose of determining the compulsory acquisition threshold would be 70%. Consequently, applying Recommendation 7, the compulsory acquisition threshold would, in effect, be 92.5% (see note 69). In determining whether that threshold had been reached, the 10% of securities to which the offeror had a s 33 deemed entitlement would also be disregarded, unless the offeror obtained an entitlement to them other than under s 33.

⁴⁰ s 701(2)(b).

⁴¹ s 701(2)(c).

- 90% by value of the total shares, or class of shares, regardless of the initial entitlement of the bidder (*total shares test*)
- 90% by value of the outstanding shares, that is, excluding shares to which the bidder is already entitled at the outset of the bid (*outstanding shares test*).

2.29 The Australian legislation adopts the total shares test,⁴² while the UK and Canada apply the outstanding shares test.⁴³ The latter test is more difficult to satisfy for bidders who have sizeable initial entitlements in the target company shares.⁴⁴

2.30 Under Australian law, a bidder cannot embark on a compulsory acquisition under s 701 unless the 90% entitlement is reached during the offer period. Theoretically the ASC could grant relief from that requirement.⁴⁵ By contrast, the UK law permits a bidder who has not satisfied the 90% outstanding shares test to apply to the court for a compulsory acquisition. The bidder must establish that the shortfall in the 90% threshold is made up of uncontactable shareholders and the bid consideration is fair and reasonable.⁴⁶

⁴² s 701(2)(b). By contrast, s 701(2)(c), by virtue of the reference to "shares subject to acquisition", adopts an outstanding shares test, but only for the limited purpose of determining whether the additional 75% in number tests in s 701(2)(c)(i), (ii) must also be satisfied.

⁴³ UK Companies Act 1985 s 429(1), (2); Canada Business Corporations Act (CBCA) (1985) s 206(2); Ontario Business Corporations Act (OBCA) (1982) s 187(1). These provisions require the bidder to acquire 90%, by value, of the outstanding shares, excluding shares of the bidder or any associate of the bidder at the outset of the bid.

⁴⁴ Consider a bidder with a 60% entitlement (other than under s 33) in the target company at the outset of the bid. Under the total shares test, the bidder must acquire 30%, by value, out of those remaining 40% of shares. Under the outstanding shares test, the bidder must acquire 36%, by value, out of those 40% of shares (nine-tenths of 40%).

⁴⁵ s 730.

⁴⁶ The UK Companies Act 1985 s 430C(5) provides that a bidder who has not satisfied the 90% outstanding shares test may apply to the court for an order authorising the bidder to dispatch compulsory acquisition notices if the court is satisfied that:

Seventy-five percent in number tests

2.31 There are two 75% in number tests in s 701:

- three-quarters of the offerees have disposed, to the offeror, of the "shares subject to acquisition" held by them: s 701(2)(c)(i) (*the acceptance test*), or
- three-quarters of the registered shareholders in the relevant class immediately prior to service of the Part A statement or the making of the Part C announcement are not so registered one month after the offer period: s 701(2)(c)(ii) (*the departure test*).

At least one of these tests must be satisfied where the bidder starts with an entitlement of more than 10% of the bid class shares.

2.32 The 75% numerical tests derived from a recommendation of the UK Cohen Committee (1945).⁴⁷ Originally, the UK expropriation powers were only available where the offeror held no more than 10% of the shares at the outset, and the scheme was approved by at least 90%, by value, of the shareholders.⁴⁸ The

-
- after reasonable enquiry the bidder has been unable to trace shareholders to whom the offer relates
 - the shares which the bidder has acquired (or contracted to acquire), together with those of the untraced shareholders, amount to not less than the nine-tenths threshold, and
 - the consideration is fair and reasonable.

The court will not make this order unless it considers that it is just and equitable to do so, having particular regard to the number of traced shareholders who did not accept the offer.

⁴⁷ *Report of the Committee on Company Law Amendment* (1945) Cmnd 6659, para 141.

⁴⁸ The UK Companies Act 1929 s 155. These powers were introduced in response to a recommendation in the *Company Law Amendment Committee (Greene Committee) Report* (1925-26) para 84 that compulsory acquisition powers were necessary to prevent the "oppression of the majority by the minority". The Committee noted that without such powers a minority could block a takeover bid for all of a company's shares either through apathy or "from a desire to exact better terms than their fellow shareholders are content to accept".

Cohen Committee considered it appropriate to permit compulsory acquisitions for schemes where the bidder already held more than the 10% share threshold. In this context it recommended a 75% acceptance test in addition to the existing 90% test. The recommendation was adopted.⁴⁹

2.33 The 75% acceptance test was reviewed by the UK Jenkins Committee (1962).⁵⁰ That Committee saw "no justification" for this additional requirement and recommended its repeal. A subsequent report also favoured repeal.⁵¹ The UK legislation was amended in 1986 to abolish this test.⁵² The Canadian legislation did not adopt any 75% test.

2.34 The original Australian legislation contained only an acceptance test.⁵³ The Edwards Committee supported its retention, subject to introducing an alternative departure test.⁵⁴

2.35 The departure test sought to overcome acknowledged defects in applying the acceptance test, in particular, uncertainty in determining the number of offerees⁵⁵ and the possibility of

⁴⁹ UK Companies Act 1948 s 209.

⁵⁰ *Report of the Company Law Committee* (1962) Cmnd 1749 para 288.

⁵¹ Memorandum by the Law Society's Standing Committee on Company Law (UK) 1984, para 21.

⁵² The UK Financial Services Act 1986 s 172 and Sch 12 amended the UK Companies Act 1985 to replace the existing ss 428-430 with a new Part XIII A (ss 428-430F), effective from 1987.

⁵³ Companies (Acquisition of Shares) Act 1980 s 42(2)(b), (3)(b), the equivalent of the acceptance test in s 701(2)(c)(i).

⁵⁴ *Report of the Joint Select Committee on Corporations Legislation* (April 1989) para 13.32 ff.

⁵⁵ It may be difficult to apply the acceptance test where the number of offerees changes significantly during the offer period. Whenever shares are transferred to a third party during a takeover bid, s 649 deems the offeror to have made a corresponding offer to the transferee, who thereby becomes an offeree: s 649(c). If only part of the shareholding is transferred, a new offer is also deemed to have been made to the transferor: s 649(d). Accordingly, where a significant number of on-market sales occur during the takeover, it may be difficult to ascertain whether s 701(2)(c)(i) has been satisfied.

The departure test in s 701(2)(c)(ii) is easier to administer, as it does not require the offeror to determine how many "offerees" exist. The

share splitting. However, as both tests are based on numbers of shareholders without regard to the value of their shareholdings, they remain vulnerable to share splitting and other artifices by offeree shareholders and bidders.

2.36 *Share splitting and other artifices by offerees.* A dissident offeree may sell multiple small share parcels to its associates before or during a bid. All these persons become "offerees", thereby making satisfaction of the acceptance test more difficult. The departure test avoids the consequences of offeree share-splitting occurring after the Part A statement is served or the Part C announcement is made.⁵⁶

2.37 An additional problem with the departure test is that a dissident who buys target shares during the bid could artificially maintain persons on the share register simply by not lodging their share transfers.

2.38 *Share splitting by bidders.* A bidder cannot take advantage of pre-bid share splitting under the acceptance test.⁵⁷ However, a bidder may employ share splitting to satisfy the departure test. An intending bidder could transfer numerous small target company share parcels to its associates, each of whom would become registered shareholders before commencement of the bid. These associates, by accepting the offer and being removed from the share register, would be counted towards meeting the departure test requirements. One possible legislative response may be to disregard all shares to which a bidder is entitled at the outset of the bid for the purpose of satisfying the departure test, regardless of the actual number of registered holders of those shares. This

departure test simply compares the number of registered shareholders on two stipulated dates, to determine whether three quarters of the original registered holders have been removed from the register, irrespective of whether they have sold to the offeror and irrespective of what other shareholders may have been added to the register.

⁵⁶ The departure test in s 701(2)(c)(ii) is concerned only with the registered shareholders at the commencement of the bid. Subsequent registrants are disregarded.

⁵⁷ The acceptance test applies only to the "shares subject to acquisition", which in turn are defined under s 701(1)(a) to exclude "shares to which the offeror was entitled when the first of the offers was made".

would also overcome the possibility that a bidder who has acquired shares prior to the bid may delay having the share register altered until the bid has begun, merely to assist in satisfying the departure test.⁵⁸

2.39 *Partial dispositions.* Neither 75% test takes into account partial dispositions. The language of s 701(2)(c) suggests that only those offerees who have disposed of all their shares to which the offer relates (the acceptance test), or who are no longer registered with respect to any of their shares (the departure test) may be counted towards the 75% requirements.

2.40 *Non-responding shareholders.* The existence of a significant number of apathetic or untraceable shareholders may also prevent satisfaction of either 75% in number test.⁵⁹ The only course open to a bidder under existing law is to seek an ASC exemption from full satisfaction of the numerical tests.⁶⁰

2.41 The Legal Committee outlined in the Issues Paper some policy options to deal with the problem of non-responding shareholders, namely to:

- reduce the consent requirement for compulsory acquisition to, say, 50% of relevant persons. However, these shareholders could still significantly influence the offeror's ability to satisfy the procedural requirements
- permit compulsory acquisition once the current 90% total shares threshold has been reached unless a certain percentage of outstanding offerees notify their dissent. This percentage could be 25% (the mirror of 75%) of

⁵⁸ An alternative approach, namely to exclude from the departure test those registered shareholders who were associates of the offeror at the outset of the bid, would not solve this problem as the vendor, having completed the transaction, may not continue to be an associate of the purchaser merely because the share transfers have not been registered by the purchaser.

⁵⁹ *TNT Ltd v NCSC* (1986) 11 ACLR 59; *Brierley v Dextran Pty Ltd* (1990) 3 ACSR 455.

⁶⁰ ASC Policy Statement 98.

outstanding offerees or even a lesser percentage, say, 20% or fewer. The legislation could require that offer documents be accompanied by a form which dissenters can complete and return to register their dissent. However, this approach runs counter to the existing rationale of s 701 which is to require overwhelming acceptance of a bid by offeree shareholders (rather than mere failure to object) as a precondition to compulsory acquisition

- . replace all existing tests in s 701 with a 90% outstanding shares test, with or without a judicial discretion to permit a compulsory acquisition where any shortfall in the acceptance threshold comprises untraceable shareholders (the UK and Canadian approach), or
- . repeal outright the 75% in number tests and retain only the existing 90% total shares test.

Issues:

- . **Should the 90% total shares test in s 701(2)(b) be replaced with a 90% outstanding shares test?**
- . **Should the 75% in number tests in s 701(2)(c) be abolished?**

Submissions on the 90% test

2.42 The submissions were divided on the merits of introducing a 90% outstanding shares test.

2.43 The ASC supported a 90% outstanding shares test. It argued that this test may reduce the likelihood of manipulation. The test would also overcome the technical problem that an offeror who is entitled to 90% or more of the target shares when it makes the bid cannot satisfy s 701(2)(b). The ASC also considered that adoption of an outstanding shares test would facilitate the abolition of the 75% in number tests.

2.44 One submission supported the change to an outstanding shares test only if the 75% in number tests are abolished.⁶¹ Another submission also favoured an outstanding shares test.⁶²

2.45 The AICD supported retaining the total shares test, arguing that the introduction of an outstanding shares test may enhance the position of professional speculators and could amount to minority dictation. The SIA also pointed out that under the outstanding shares test, the larger the stake held by the offeror at the commencement of the bid, the harder it would be to move to compulsory acquisition.

2.46 The Law Council was inclined towards retention of the total shares test in view of the commercial benefits of enabling compulsory acquisition to proceed as a conclusion to a takeover scheme.

Submissions on the 75% in number tests

2.47 The submissions were divided on whether to retain these tests.

2.48 The AICD argued that the 75% acceptance test was fundamentally flawed and its retention could not be justified, given the absence of any analogous requirement in either the UK or any North American jurisdiction. Another submission considered that the difficulties in satisfying any 75% in number test far outweighed any policy reasons for its retention.⁶³ For instance, the test may be used by greenmailers on the register to prevent compulsory acquisition.

2.49 One submission considered that it would be preferable to adopt a single test referable to the number of voting shares outstanding, with the ASC having a discretion to specify a lower

⁶¹ Rosenblum *Submission*.

⁶² Corrs *Submission*.

⁶³ Rosenblum *Submission*.

number where there was a large number of uncontactable shareholders.⁶⁴

2.50 The ASC supported abolition of any 75% in number test, provided the 90% entitlement test was amended from a total shares test to an outstanding shares test.

2.51 The SIA and IBSA supported retention of the departure test, which should apply to all bids, though it should refer to 50% of offerees. The SIA observed that the 75% in number tests are much more onerous than a special resolution because they relate to all shareholders, not just shares held by members present and voting. IBSA also supported the departure test.

2.52 The Law Council said that some of its members favoured abolishing any 75% in number requirement. However, other members of the Council considered that retention of the 75% in number tests would provide a clear demonstration of procedural fairness through the independent commercial judgment of remaining shareholders.

Legal Committee response

2.53 The Legal Committee considers that there are compelling reasons for abolishing the 75% in number tests.⁶⁵ However, to employ only the total shares test may not ensure that the bid price has been overwhelmingly accepted by offeree shareholders where a bidder starts with a high initial entitlement.⁶⁶ This could enable

⁶⁴ Corrs *Submission*.

⁶⁵ See paras 2.36-2.40, *supra*.

⁶⁶ The following table shows that under a total shares test alone, the percentage of remaining shares, by value, to be acquired to move to compulsory acquisition is less for a bidder with a high initial entitlement. That rate of decrease increases significantly for initial entitlements above 60%.

90% total shares test threshold

Initial entitlement (%)	Percentage of remaining shares, by value, to be acquired to achieve this threshold
0	90

a bidder to acquire the remaining shares at a price not accepted by many remaining shareholders.

2.54 The Legal Committee has considered two other policy options for determining the compulsory acquisition threshold:

- substitute a 90%, by value, of outstanding shares entitlement test (the 90% outstanding shares test) for all existing threshold tests, or
- retain the 90% total shares test, but replace the 75% in number tests with a 75%, by value, of outstanding shares entitlement test (the 90% total/75% outstanding shares test).

2.55 The former option would require a bidder to gain an entitlement to 90%, by value, of those bid class shares⁶⁷ to which the bidder was not entitled at the commencement of the bid.⁶⁸ The latter option would reduce that outstanding shares entitlement threshold to 75%, by value, but ensure that in no instance would the entitlement threshold for compulsory acquisition be less than 90%, by value, of the total bid class shares.⁶⁹

50	80
60	75
70	66.6
80	50
85	33.3
just less than 90	approximately 10

⁶⁷ Later issued shares of the bid class would not be bid class shares unless the bidder wished to compulsorily acquire them: Recommendation 4, *supra*.

⁶⁸ Note Recommendation 6, *supra*, to exclude securities of a bid class in which an offeror only has a deemed interest under s 33 for the purpose of determining the compulsory acquisition threshold and whether it has been satisfied.

⁶⁹ The following table sets out the compulsory acquisition entitlement threshold under the two tests, depending on a bidder's initial entitlement.

2.56 These two methods would differ as follows.

- The 90% outstanding shares test, in effect, would increase the compulsory acquisition threshold above a 90% of total shares entitlement for any bidder with any initial entitlement whatsoever. By contrast, the 90% total/75% outstanding shares test, in effect, would only raise this threshold beyond a 90% of total shares entitlement for bidders with an initial entitlement in excess of 60% of the bid class shares.
- The compulsory acquisition entitlement threshold would always be materially higher under the 90% outstanding shares test than under the 90% total/75% outstanding shares test.

2.57 The Legal Committee prefers the 90% total/75% outstanding shares entitlement test for determining the compulsory acquisition threshold for a Chapter 6 bid.

2.58 The presence of untraceable or apathetic shareholders may prevent a bidder from reaching the proposed new compulsory acquisition threshold. However, this may be less likely than under the present 75% in number threshold. In addition, the Legal Committee considers that this problem can be dealt with by:

Initial entitlement (%)	90% outstanding shares test (%)	90% total shares test and 75% outstanding shares test (%)
0	90	90
10	91	90
20	92	90
30	93	90
40	94	90
50	95	90
60	96	90
70	97	92.5
80	98	95
90	99	97.5
95	99.5	98.75

- the ASC⁷⁰ and the court⁷¹ having power to reduce the compulsory acquisition threshold (particularly relevant where there are large numbers of untraceable shareholders)
- persons who have satisfied the 90% full beneficial interest threshold using the proposed new compulsory acquisition procedure.⁷²

Recommendation 7: The 90% total shares entitlement test in s 701(2)(b) should be retained (though amended to refer to bid class securities) but the 75% in number tests in s 701(2)(c) should be replaced with a test of entitlement to 75%, by value, of outstanding bid class securities.⁷³

Discretion to reduce the compulsory acquisition threshold

Issue: Should a bidder be permitted to seek court approval of a compulsory acquisition, notwithstanding that some aspect of the threshold test is not satisfied? Should any such right include, or be confined to, instances where untraceable shareholders prevent the fulfilment of that test? Should any right to seek court approval substitute for, or be in addition to, the right in such cases to seek an ASC modification under s 730?

Submissions

2.59 Submissions generally supported the court having a general discretion.

⁷⁰ cf Policy Statement 98.

⁷¹ Recommendation 8, post.

⁷² See paras 10.1 ff. A person who has a 90% total shares entitlement but cannot satisfy the 75% outstanding shares requirement can acquire further shares in any manner under the current Chapter 6 to reach the 90% full beneficial interest threshold and thereafter employ the new procedure. Section 615 does not prohibit these further acquisitions.

⁷³ Following from this recommendation, Issues 7, 8, 9, 10 and 12 of the Issues Paper are no longer relevant.

2.60 The ASC argued that the right to seek court approval should not be confined to instances where untraceable shareholders prevent the fulfilment of the requisite test. It may be appropriate for compulsory acquisition to proceed even though the requisite test has otherwise not been fulfilled. The right to seek court approval should be in addition to the right to seek an ASC modification under s 730. However, the ASC may wish to make submissions to the court on relevant policy issues. It should have standing in any such application.⁷⁴ The Commission further considered that the court should be able to deal with matters on the merits and not simply review any administrative decision of the Commission. Given this, the ASC should have the right to require an application to be determined by the court.

2.61 The Law Council said that this right should be in addition to the right to seek an ASC modification under s 730.

Recommendation 8: A bidder should be permitted to seek court approval of a compulsory acquisition, notwithstanding that the compulsory acquisition threshold has not been reached. This right should not be confined to instances where the presence of untraceable security holders prevents reaching the threshold. It should be in addition to the right to seek an ASC modification under s 730. The ASC should have the right to require that an application be dealt with by the court.

Rights of dissidents

Court application to challenge compulsory acquisition

2.62 A bidder who satisfies the compulsory acquisition threshold can acquire all remaining shares of the bid class, subject to one or more remaining holders applying to the court, within one month of the expropriation notice being given, to prevent their shares being expropriated.⁷⁵ The notice cannot be dispatched before the

⁷⁴ The Commission may intervene in any proceedings relating to any matter arising under the Corporations Law: s 1330.

⁷⁵ s 701(6).

close of the offer period, even if the acceptance prerequisites for an unconditional offer have already been fulfilled.⁷⁶ Any application by dissidents does not affect the right of the bidder to compulsorily acquire the shares of those remaining shareholders who do not apply to the court. However, there is some doubt whether the bidder need acquire those shares before all court applications have been disposed of.⁷⁷ The UK law also entitles one or more dissidents to seek an exemption from acquisition of their shares.⁷⁸ Not all Canadian jurisdictions permit these applications.⁷⁹ US short-form merger law makes no provision for dissidents to challenge the right of compulsory acquisition.⁸⁰

⁷⁶ In *Elkington v Vockbay Pty Ltd* (1993) 10 ACSR 785, the Court ruled invalid the dispatch of compulsory acquisition notices before the close of the offer period, arguing that it would "be inimical to [the] principles [of shareholders having full information and adequate time to make a decision] to allow the offeror, without intervention from the regulatory authority, to truncate time periods apparently set for the protection of the shareholder" (at 800). D Grave, *supra* note 4 at 242, argues that immediate dispatch of the notice should be permitted for unconditional bids, with dissident shareholders being protected by their rights under s 701 to request a written statement of the names and addresses of the dissenting offerees and to make a court application.

⁷⁷ D Grave, *supra* note 4 at 250-1, points out that as disposal of the last court application under s 701(10)(c) will usually be the last event to happen, the provision could be interpreted as indicating that those shareholders who do not make a court application may need to wait until that time before having their shares acquired. He argues that it would be unreasonable to deny those shareholders who do not proceed with a court application the opportunity to receive the offer consideration for their shares at the earliest possible date. He points out that considerable amounts of money could be involved and the offeror's obligation to acquire these shares is unaffected by the outcome of those court applications which do proceed.

⁷⁸ UK Companies Act 1985 s 430C(1)(a).

⁷⁹ The CBCA and the OBCA do not provide for any exemption from a proper expropriation. By contrast, the British Columbia Company Act (1979) s 279 permits the court to prohibit the expropriation of the dissident's shares.

⁸⁰ The Delaware General Corporation Law s 253 empowers a parent corporation which owns at least 90% of the shares of each class of stock of a subsidiary corporation unilaterally to merge with the subsidiary and pay the subsidiary's minority shareholders cash for their shares. A merger resolution of the parent company's board of directors is the only requirement. If the subsidiary is not wholly owned, the resolution must

Issue: Should an offeror under an unconditional offer be entitled to dispatch compulsory acquisition notices (and the requisite time periods for objection commence to run) once the acceptance requirements for compulsory acquisition are fulfilled, even where the offer period is still open?

Submissions

2.63 Respondents, other than the ASC, generally supported an offeror having the right of early dispatch of compulsory acquisition notices.

2.64 One submission argued that there was no reason to delay the notices once the offer was unconditional.⁸¹ The Law Council agreed, pointing out that the timing of notices may be relevant to the offeror for a number of reasons, for instance tax grouping. It is desirable to give offerors an incentive to offer all shareholders a higher price by making the taxation benefits of grouping available as soon as possible.

2.65 By contrast, the ASC agreed with the view in *Elkington v Vockbay Pty Ltd* that it would "be inimical to [the] principles [of shareholders having full information and adequate time to make a decision] to allow the offeror, without intervention from the regulatory authority, to truncate time periods apparently set for the protection of the shareholder".⁸²

set out the terms and conditions of the merger, including the consideration to be offered by the surviving corporation to the minority shareholders upon expropriation of their shares. Minority shareholders may require a court appraisal of the intrinsic worth of their shares, rather than accept the offer price. Shareholders cannot challenge the right of acquisition. In an appraisal action, "the only litigable issue is the determination of the value of the appraisal petitioners' shares on the date of the merger, the only party defendant is the surviving corporation and the only relief available is a judgment against the surviving corporation for the fair value of the dissenters' shares": *Cede & Co v Technicolor Inc* (Del. 1988).

⁸¹ Corrs *Submission*.

⁸² (1993) 10 ACSR 785 at 800.

Legal Committee response

2.66 The Legal Committee cannot identify any disadvantage to any party in permitting an offeror to dispatch compulsory acquisition notices in an unconditional bid at any time during the bid, once the compulsory acquisition threshold has been reached.

Recommendation 9: An offeror under an unconditional offer should be entitled to dispatch compulsory acquisition notices (and the requisite time periods for objection commence to run) once the compulsory acquisition threshold has been reached, even where the offer period is still open.

Issue: Should remaining shareholders who do not proceed with a court application be entitled to receive the relevant offer consideration in the period prescribed under s 701(10)(a) or (b) (whichever last occurs), not that under s 701(10)(c)?

Submissions

2.67 Submissions supported shareholders who do not proceed with any court application opposing the compulsory acquisition of their shares having this right.

2.68 The ASC observed that the right of dissenting shareholders to apply to the court will have expired and the outcome of any application on foot will not affect those remaining shareholders who do not proceed with a court application. The Law Council also agreed that remaining shareholders who do not proceed with a court application should receive their consideration in the earlier period.

2.69 One submission favoured the offeror having this option.⁸³ It may suit the bidder to make all compulsory acquisitions at the same time.

Legal Committee response

⁸³ Rosenblum *Submission*.

2.70 The Legal Committee agrees with the submissions and the observations of one commentator that it would be unreasonable to deny remaining holders of bid class securities who do not proceed with a court application the opportunity to receive the offer consideration for their securities at the earliest possible date.⁸⁴

Recommendation 10: Remaining holders of bid class securities who do not proceed with a court application opposing the compulsory acquisition of their securities should be entitled to receive the offer consideration in the period prescribed under s 701(10)(a) or (b) (whichever last occurs), not that under s 701(10)(c).

Information about other dissidents

2.71 Dissenting shareholders may request particulars of all other remaining shareholders.⁸⁵ This may enable dissidents to co-operate in resisting compulsory acquisition through joint court action and by sharing costs. However s 701(6), as drafted, may not fully achieve this goal.⁸⁶

⁸⁴ See note 77, supra.

⁸⁵ s 701(9).

⁸⁶ Shareholders may in effect find themselves precluded from taking joint action, depending on when they apply for a statement listing other dissenting offerees. Subsection 701(6) requires a dissident to make a court application before the later of either:

- the expiration of one month from when the offeror gave notice to dissenting offerees under s 701(2) (s 701(6)(a)), or
- 14 days following the day the dissident received a statement under s 701(9) (s 701(6)(b)).

Assume dissident A gives notice under s 701(9) immediately after receiving the s 701(2) notice, and within a day or two receives a statement under s 701(9). The time period for dissident A to make a court application would then be determined by s 701(6)(a), given that the 14 day period in s 701(6)(b) would expire earlier. By contrast, dissident B who seeks a statement under s 701(9) late in the month following the giving of the s 701(2) notice, and receives it after expiration of that month (and expiration of the period for A to make a

Issue: Should s 701(6)(b) be amended to refer to the end of 14 days after the last day on which any dissenting offeree was given a statement under s 701(9)?

Submissions

2.72 Submissions supported this amendment.

2.73 One submission pointed out that as the courts have examined applications by reference to the interests of shareholders as a whole, it is only appropriate that dissenters are given equal opportunities to make a combined application to the courts.⁸⁷ The Law Council said that this amendment will increase the opportunities for dissenting offerees to use representative or class action procedures.

Recommendation 11: Paragraph 701(6)(b) should be amended to refer to the end of 14 days after the last day on which any dissenting offeree was given a statement under s 701(9).

Fairness criteria

2.74 In determining applications by dissidents opposing the compulsory acquisition of their shares, Australian courts have adopted the principle that s 701 should not be given a narrow construction, but one which facilitates takeovers which have overwhelmingly succeeded. The ultimate test is fairness to the body of shareholders as a whole, not fairness to a particular dissenting shareholder. In determining fairness, the courts have applied various guidelines.⁸⁸

court application under s 701(6)(a)), still has a further 14 days under s 701(6)(b) to commence proceedings.

⁸⁷ Rosenblum *Submission*.

⁸⁸ *Elkington v Vockbay Pty Ltd* (1993) 10 ACSR 785 at 793-4; *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 587, 590-1. See generally Renard & Santamaria, *supra* note 4 at [1209], [1210], and HAJ Ford & RP Austin *Ford's Principles of Corporations Law* (7th ed), Butterworths, 1995, para [24.260].

- . The level of acceptances from shareholders as a whole will be relevant. A very high level of acceptances from shareholders independent of the offeror prima facie suggests that the offer is fair.
- . In the absence of strong alternative grounds, the court should be guided by what commercial people concerned with the transaction think about the offer and should be slow to substitute its own view of the fairness of the scheme in opposition to the stand apparently taken by the majority of those directly involved.
- . The degree of compliance with statutory formalities could impinge on the notions of fairness.
- . The court is not restricted to examining the consideration offered, but may investigate the conduct of the offeror in the period preceding the offer.
- . Legitimate commercial or administrative advantages to the company may be considered by the court in assessing the overall fairness of an offer.⁸⁹
- . The courts consider, but are not bound by, views expressed in any independent expert's report whether the bid price is fair and reasonable.⁹⁰
- . Past and present market price and net asset backing are also relevant.⁹¹

⁸⁹ See supra note 4.

⁹⁰ *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 593.

⁹¹ In *Catto v Ampol Ltd* (1989) 15 ACLR 307, Rogers AJA adopted the comments in *Kingston v Keprose Pty Ltd (No 2)* (1988) 6 ACLC 111 that in the circumstances the current stock market price was not a fair indication of value, as one party had acquired nearly all the shares in the target, thereby depressing the price. Likewise, Jacobs J in *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 578 stated that "the manifest legislative purpose of fair

2.75 The onus is on the dissenting shareholder to establish that the offer was unfair. Merely demonstrating that the offer is open to criticism or could be improved does not establish unfairness. The courts have exercised considerable flexibility in determining whether unfairness has been established, taking into account:

- any element of cheating, deception or impropriety
- any attempt by the majority shareholder to operate the company prior to the takeover bid in a way which substantially reduced the value of minority shareholdings
- materially misleading statements in the offer documents which may have influenced the majority to accept, contrary to their best interests
- evidence that independent advice on which the target board based a recommendation to accept the bid was fundamentally flawed, or
- evidence that the consideration offered was unfairly low.⁹²

Issue: Are the existing judicial guidelines concerning the right of a dissident shareholder to seek exemption from a compulsory acquisition appropriate? Should any principles be set out in the legislation?

dealing with minority interests would be defeated ... if the terms of their exit are to be dictated simply by the market place". However if the offer price exceeds the net asset backing per share, it is likely that the offer will be found to be fair. In *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583, the NSW Court of Appeal considered the prices at which the shares were traded on the stock exchange up to the time when the takeover offer was announced as highly relevant to determining their value, and therefore the fairness of the offer price. The Court described the exchange market price as cogent, but not conclusive, evidence of the shares' true value.

⁹² Renard & Santamaria, supra note 4 at [1210].

Submissions

2.76 The submissions supported the existing judicial guidelines.

2.77 The Law Council raised concerns about the possible implications of the High Court decision in *Gambotto*, and the need for the legislation to clarify that the principles in that case did not apply to s 701.

Recommendation 12: The legislation should make clear that the Gambotto principles do not apply to compulsory acquisitions under s 701.

Issue: Is it appropriate for the onus to rest on a dissident shareholder and for the circumstances of the shareholders as a whole to be used in assessing fairness to dissidents?

Submissions

2.78 Submissions supported placing the onus on the dissident and using the circumstances of the shareholders as a whole in assessing fairness to dissidents.

2.79 The ASC argued that where the requirements of s 701 have been met, there is a prima facie case that the offer is fair. The ASC also considered it appropriate for the circumstances of the shareholders as a whole to be used in assessing fairness to dissidents. The Commission noted the Eggleston principle that, so far as practicable, each shareholder should have an equal opportunity to participate in the benefits offered under a takeover bid. It would be unfair to assess fairness by reference to the circumstances of only some shareholders and it would be even more unfair to expect an offeror, or indeed the courts, to investigate the circumstances of every shareholder.

2.80 The AICD also agreed that the question of fairness must be judged by the circumstances of the shareholders as a whole.

Legal Committee response

2.81 The rationale of s 701 is that a bidder's right to compulsorily acquire remaining shares on the same terms as under the offer, and casting the onus on dissidents to challenge that right in relation to their own shares, should only arise where an offer has been overwhelmingly accepted by offeree shareholders.⁹³ The Legal Committee elsewhere makes recommendations to require this high level of acceptance.⁹⁴ In consequence, it supports the onus remaining on dissidents.

Recommendation 13: The onus in s 701 should remain on any dissident holder. Fairness should be assessed by reference to the circumstances of the holders as a whole.

Appraisal rights

2.82 Under the UK legislation, a dissenting shareholder may apply to the court to vary the bidder's terms for compulsory acquisition.⁹⁵ Canadian law also permits a minority shareholder either to take the consideration offered in the bid or to seek a court determination of "fair value".⁹⁶ Canadian courts may join all

⁹³ cf *Eddy v WR Carpenter Holdings Ltd* (1985) 10 ACLR 316 at 318.

⁹⁴ Recommendations 6 and 7, *supra*.

⁹⁵ The UK Companies Act 1985 s 430C(1)(b) empowers a court to "specify terms of acquisition different from those of the offer". These appraisal rights were first recommended by the Greene Committee, *supra* note 48, at para 85.

⁹⁶ CBCA s 206(3)(c)(ii), OBCA s 187(2)(c)(ii). D Peterson *Shareholder Remedies in Canada* (Butterworths 1992) para 4.20-4.40 points out that Canadian courts have considered various issues in determining fair value in an appraisal proceeding. These are:

- hindsight: whether information arising after the valuation date may be used in determining fair value
- minority discounts: whether there should be any reduction in the price attached to minority shares because they do not represent control of the corporation
- expropriation premium: whether a premium should be added to the fair value of minority shares to compensate minority shareholders who are being forcibly removed or squeezed-out from the company

dissenting shareholders and fix a fair value for their securities.⁹⁷ The court may also appoint appraisers to assist in determining a fair value.⁹⁸ US short-form merger laws contain similar appraisal rights.⁹⁹ By contrast, Australian courts are limited to approving or refusing the compulsory acquisition of a dissident applicant's shares and, apparently, only on the terms offered in the takeover bid. They have no express power under s 701 to alter the consideration,¹⁰⁰ or to make orders affecting those non-accepting shareholders who do not make an application.

Issue: Should a dissenting shareholder be entitled to seek a variation of the terms of an acquisition (appraisal rights)? If so:

-
- . conduct of parties: whether the conduct of either the majority or the minority should affect the price
 - . synergistic benefits: whether or not valuation should take into account the activities in which the company will engage after the share purchase has taken place.

⁹⁷ CBCA s 206(14), (15); OBCA s 187(17), (18).

⁹⁸ CBCA s 206(16); OBCA s 187(19).

⁹⁹ Under the Delaware General Corporation Law s 262, the corporation or a dissident shareholder may petition the court for a valuation of the shares. The court "shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the court shall take into account all relevant factors. The court may, in its discretion, permit discovery or other pre-trial proceedings".

¹⁰⁰ *Kingston v Keprose Pty Ltd (No 2)* (1987) 12 ACLR 599 at 605: "[s 701], which relates to compulsory acquisitions, seems to make the terms of the offer the only available terms on which the compulsory acquisition is to take place, to be escaped from only under [s 701(6)] and only by obtaining a court order defeating compulsory acquisition itself". Contrast *Plaza Fabrics (Tauranga) Ltd v National Airlines Co Ltd* (1991) 5 NZCLC 96-486, a case on the equivalent of s 414, but which, by comparing the equivalent of ss 701 and 703, argued that a court, under s 414 at least, is not restricted to merely approving or prohibiting a disputed acquisition, but may impose terms. D Grave, supra note 4, also questions whether the court has power under s 701(6) to vary the terms of the acquisition. Renard & Santamaria, supra note 4 at [1211], suggest that the court may have an inherent or implied power under s 701(6) to award interest on the consideration payable under an offer to a dissenting offeree.

- (a) should a court or an administrative body (for instance, experts appointed by the ASC) conduct the appraisal**
- (b) what, if any, specific powers or directions should be set out in the legislation?**

Who, if anyone, in addition to the applicant should have the benefit of any variation of the terms of acquisition?

Submissions

2.83 The submissions generally favoured the court rather than an administrative body conducting any appraisal. A number of submissions opposed the court having any power to substitute a higher price. Rather, it should merely approve or refuse the compulsory acquisition.

2.84 The SIA said that the offeror should not be bound to pay a higher price than it has already offered. Another submission considered that the offeror must have certainty about the price it is able and willing to pay. A court should not be empowered to force an offeror to proceed with the transaction when it may not commercially be able to do so.¹⁰¹

2.85 The ASC did not support dissidents being entitled to seek a variation of the terms of acquisition under s 701. It pointed out that an offeror may not have the financial resources to acquire the shares at any higher price determined by the court. Also, substitution of any higher price for dissidents would offend the Eggleston principles of treating all shareholders equally. Rather, any court power should be limited to either approving or rejecting the buy-out price.

2.86 The Law Council said that the appraisal should be determined by the court and specific powers or directions should be set out in the legislation. However, the power should relate solely to instances where exceptional circumstances have arisen rendering it fair that dissenting shareholders receive a higher price than that paid to other offerees under the takeover scheme, and the benefit should be confined to shareholders who have undertaken the court action. If the alternative view (of giving the benefit to all persons whose shares have been compulsorily acquired) were adopted, it might well be argued that the benefit should also be extended to accepting offerees. This would impose unreasonable financing burdens on the acquirer and would amount to a jurisdiction to rewrite the relevant takeover scheme.

¹⁰¹ Rosenblum *Submission*.

Another submission argued that only dissenting shareholders should receive any higher price.¹⁰²

Legal Committee response

2.87 Taking all these submissions into account, the Legal Committee considered two alternatives:

- permitting the court to alter the offer price, but giving the offeror the option in that instance to withdraw the offer to dissidents who have applied to the court, or
- limiting the court's powers to either approving or rejecting the offer price for dissidents who have applied to the court.

2.88 The Legal Committee supports the second alternative. It considers that it is inappropriate for a court to determine a specific compulsory acquisition price in cases of dispute.¹⁰³ If the court rejects the offer price, the offeror could subsequently acquire the shares held by dissidents either by private agreement, through a subsequent Chapter 6 bid¹⁰⁴ or, where appropriate, under the proposed new compulsory acquisition procedure.¹⁰⁵

2.89 The Legal Committee also considers that there should be some non-exhaustive legislative guidance on assessing the fair value of the offer price. It notes that the terms for compulsory acquisition under s 701 must be the same as those for the takeover bid.¹⁰⁶ Given this, a court should:

¹⁰² Corrs *Submission*.

¹⁰³ cf para 10.35, post.

¹⁰⁴ See Recommendation 5, supra.

¹⁰⁵ To exercise the proposed new compulsory acquisition power, an entity must have the entire beneficial interest in at least 90% of the bid class securities: para 10.12. A person with a 90% entitlement to a particular class of securities may not necessarily have a 90% full beneficial interest in those securities. That person could acquire further securities in that class in any manner to reach the 90% beneficial interest threshold, given that s 615 does not prohibit those further acquisitions.

¹⁰⁶ s 701(5).

- assess the value of the company as a whole and determine the value of each class of issued security, taking into account its relative financial risk and its distribution rights
- expressly disregard whether the remaining securities of the offer class should attract a premium or discount.

Recommendation 14: A court, rather than an administrative body, should conduct any appraisal. Its powers should be limited to either approving or rejecting the compulsory acquisition price for all dissenting applicants. In determining fair value, a court should:

- *assess the value of the company as a whole and determine the value of each class of issued security, taking into account its relative financial risk and its distribution rights*
- *expressly disregard whether the remaining securities of the offer class should attract a premium or discount.*

If the court decides to reject the compulsory acquisition price as not being for fair value, the compulsory acquisition should fail for all dissidents who have applied to the court.

Costs orders

2.90 Under the UK legislation, no costs order may be made against a dissenting applicant shareholder unless the court considers that the application was unnecessary, improper or vexatious or that the applicant is otherwise acting unreasonably.¹⁰⁷ Canadian law provides that shareholders

¹⁰⁷ UK Companies Act 1985 s 430C(4). In *Re Britoil plc* [1990] BCC 70 at 74, the UK Court of Appeal described the general purpose of s 430C(4) as "not to discourage [dissenting shareholders] from applying except in cases which ought not properly to engage the attention of the court. If there is something which it is proper for the court to consider, the

exercising their appraisal rights are not required to give any security for costs in an application.¹⁰⁸ The US short-form merger laws empower the court to order that expenses incurred by any applicant shareholder may be charged against the shares entitled to be appraised.¹⁰⁹ There are no specific costs powers in s 701 though the courts, on occasion, have varied the usual rule in civil litigation that costs must be borne by the unsuccessful party.¹¹⁰

**Issue: Should there be specific provisions dealing with cost orders?
If so, what principles should apply?**

Submissions

2.91 A number of submissions considered that the court should retain its discretion in respect of costs and that specific legislative provisions were unnecessary. The ASC believed that any legislation should follow the UK approach. The Law Council did not support any specific provisions dealing with cost orders.

applicant, even though unsuccessful, ought not to have to pay the offeror's costs".

¹⁰⁸ CBCA s 206(13); OBCA s 187(16).

¹⁰⁹ The Delaware General Corporation Law s 262 provides that: "... The cost of the proceeding may be determined by the court and taxed upon the parties as the court deems equitable in the circumstances. Upon application of a stockholder, the court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding ... to be charged pro rata against the value of all of the shares entitled to an appraisal."

¹¹⁰ Renard & Santamaria, supra note 4 at [1211], relying mainly on UK case law, state that courts have been prepared on occasion to award costs against the offeror even though the dissenting offeree was unsuccessful in preventing compulsory acquisition. However, it is more common in compulsory acquisition litigation for a court to make no order for costs, leaving each party to bear its own legal expenses: *Re Deans* [1986] 2 NZLR 271 at 278; *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 594. In some compulsory acquisition cases, costs have been awarded against the applicant in full on the initial application (eg *Williams v United Dairies Ltd* (1986) 10 ACLR 406; *Brierley v Dextran Pty Ltd* (1990) 3 ACSR 455 at 469-70) or following an unsuccessful appeal (*Elkington v Shell Australia Ltd*).

Legal Committee response

2.92 The Legal Committee considers that questions of costs should remain within the discretion of the court. This differs from the approach taken in the proposed new procedure.¹¹¹ This policy difference concerning costs arises from compulsory acquisitions under s 701, but not under the proposed new procedure, being dependent upon overwhelming acceptance of the compulsory acquisition price during the course of the Chapter 6 bid. Given this, there is a *prima facie* presumption that the offer price is fair to dissidents.

Recommendation 15: There should be no specific provision in s 701 dealing with cost orders.

Other matters

2.93 One respondent pointed out that it may be difficult for offerors to know when they can finalise a s 701 compulsory acquisition.¹¹² Subsection 701(10) enables the offeror to proceed at the end of one month after the compulsory acquisition notice was "given" (assuming certain other events have not occurred). A notice is deemed "given" when it would be received in the ordinary course of post.¹¹³ This can give rise to uncertainties when the dissenting offerees are in various locations, including overseas. The one month period could expire at different dates depending on how long it would take the notice to be received by each dissenting offeree. If the timing difference were more than 14 days (which is conceivable if a dissenting offeree is located in a remote part of the world), the offeror might have to serve two series of notices under s 701(10) to ensure that it complied with the legislation.

¹¹¹ Contrast para 10.37 and 10.38.

¹¹² Freehill Hollingdale & Page *Submission* (Freehill *Submission*).

¹¹³ ss 109X, 109Y.

Legal Committee response

2.94 The Legal Committee notes that similar uncertainty may arise with the timing of compulsory acquisition notices under s 701(2). The Committee therefore supports a general amendment to s 701 to clarify the meaning of "given".

Recommendation 16: The legislation should provide that any notice under s 701(2) or (10) is deemed to be given on the day after it is posted by ordinary mail.

Buy-outs: s 703**Outline**

3.1 Section 703 permits offerees and other security holders to require a successful bidder to compulsorily acquire their securities. Holders of shares of the bid class not sold to the bidder under the bid (remaining shares),¹¹⁴ and holders of non-voting shares, renounceable options and convertible notes (non-bid securities),¹¹⁵ may require their purchase by a bidder who becomes entitled to not less than 90% of the voting shares of the relevant class (for remaining shares), or 90% of all voting shares (for non-bid securities), during the takeover period.

Legal Committee view

3.2 The Legal Committee elsewhere proposes that the Chapter 6 bid procedure, including s 701, be available for any class of securities.¹¹⁶ The Committee supports remaining holders of securities of the bid class, and holders of any other securities, including options, that are convertible into that class, having buy-out rights under s 703. Those rights should arise when the compulsory acquisition threshold for the bid class securities has

¹¹⁴ s 703(1). The term "remaining shares" as used in s 703(1)-(2) is not defined.

¹¹⁵ s 703(4).

¹¹⁶ Recommendation 2, *supra*.

been satisfied.¹¹⁷ However, the Legal Committee opposes the current application of the buy-out requirements to other securities which are not convertible into bid class securities, as:

- . the forced acquisition of some or all of these other securities could impose an excessive financial burden on a successful bidder
- . a target company might issue a large number of these other securities as an indirect takeover defence¹¹⁸
- . holders of these other securities will acquire them in the knowledge that a successful bid for the voting shares could take place in circumstances beyond their control. A change in the identity of the owner of the voting shares does not justify permitting holders of non-convertible preference shares to require their acquisition.

Recommendation 17: The right of buy-out under s 703 should be limited to remaining securities of the bid class and other securities convertible into the bid class. That right should arise once the compulsory acquisition threshold for the bid class securities has been satisfied.

Restrictions on eligible holders

3.3 There are various limitations in s 703. Holders of shares that are of the same class as "remaining shares" but are issued after the commencement of the bid (later issued bid class shares) cannot require their acquisition under this provision.¹¹⁹ Holders of voting

¹¹⁷ See Recommendation 7, supra, on the compulsory acquisition threshold.

¹¹⁸ The Legal Committee recognises that various ASX Listing Rules, including 3E and 3R, place controls on new issues. However, these impose only partial restraints.

¹¹⁹ Subsection 703(1) refers to notices being given to holders of remaining shares in the class that had not received compulsory acquisition notices under s 701(2). Presumably this refers to holders who were entitled to receive s 701(2) notices if the bidder had chosen to compulsorily acquire those shares. However, s 701(2) notices currently cannot be given for these later issued shares: see, para 2.11, supra.

shares not included in the class of shares to which the bid related also fall outside s 703.¹²⁰

Issue: Should holders of later issued bid class shares be entitled to require their acquisition in the event of a successful bid?

Submissions

3.4 The submissions were divided on whether the holders of later issued bid class shares should have this acquisition right.

3.5 One submission argued that it is only fair that holders of the shares have an opportunity to leave the company. Otherwise they may find themselves as a locked-in minority.¹²¹

3.6 Some submissions argued against holders of these shares having this acquisition right. It could substantially increase the consideration needed for a takeover offer. Also, holders of these shares must, or should, know that they could be effectively locked in if the takeover bid is successful.¹²²

3.7 The SIA was also concerned that this would create a defensive mechanism. Also, shareholders who acquire later issued bid class shares do so in the knowledge of the bid. However, the SIA considered that shareholders holding shares issued pursuant to a convertible security on issue at the date of announcement of the bid should have the benefit of s 703.

Legal Committee response

3.8 The Legal Committee elsewhere recommends that a successful bidder have the option under s 701 to compulsorily acquire all later issued bid class securities.¹²³ Holders of these securities should have a comparable right to require their

¹²⁰ The relevant provision, s 703(4), only applies to holders of non-voting shares and holders of options or convertible notes. It does not deal with holders of any remaining class of voting shares.

¹²¹ Rosenblum *Submission*.

¹²² Law Council *Submission*; Corrs *Submission*.

¹²³ Recommendation 4, *supra*.

acquisition under s 703. A bidder should budget for these possible buy-out requirements. Moreover, not to extend this right would prejudice persons who had converted, given that convertible securities fall within s 703. Likewise, holders of later issued bid class securities would not have had an earlier opportunity to accept the bid. This extended right should only apply to bid class securities issued during the bid period. A bidder could also protect itself by including a condition in its offer that it may withdraw the bid if any, or more than a stated proportion of, bid class securities are issued during the bid period.

Recommendation 18: Section 703 should apply to holders of bid class securities issued after commencement of the bid but prior to close of the offer period (unconditional bids) or issue of the s 663(4) notice (conditional bids).

Issue: Should holders of voting shares in a non-bid class be entitled to require their acquisition under s 703?

Submissions

3.9 The submissions were divided. The ASC and the SIA supported these holders being entitled to require acquisition of their shares, to avoid them becoming a locked-in minority. The Law Council did not support this extended entitlement.

Legal Committee response

3.10 The Legal Committee elsewhere recommends that the right of buy-out should be limited to remaining securities of the bid class and any other securities convertible into the bid class.¹²⁴ The Legal Committee does not support any further extension of s 703.

Recommendation 19: Section 703 should not apply to voting shares in a non-bid class unless they are convertible into the bid class.

Non-renounceable options

3.11 Holders of non-renounceable options cannot request their acquisition under s 703.¹²⁵ The Legal Committee raised for consideration in the Issues Paper whether this restriction should remain.

Issue: Should holders of non-renounceable options be given the same powers as holders of renounceable options to require acquisition by the bidder?

Submissions

3.12 Submissions generally favoured holders of non-renounceable options being given this power.

3.13 The AICD supported this change, notwithstanding that it would override the contractual terms of the options involved. The SIA observed that this problem could be overcome by allowing cancellation of the option by the issuing company in place of transfer to the offeror.

3.14 Two respondents supported this extended power, provided the non-renounceable options are over shares of the same class as those to which offers were made.¹²⁶

Legal Committee response

3.15 The Legal Committee elsewhere recommends that the right of buy-out should be limited to remaining securities of the bid class and any other securities convertible into the bid class.¹²⁷ These convertible securities should include renounceable and non-renounceable options.

¹²⁴ Recommendation 17, *supra*.

¹²⁵ Non-renounceable options are often issued under employee share schemes.

¹²⁶ Law Council *Submission*; Corrs *Submission*.

¹²⁷ Recommendation 17, *supra*.

Recommendation 20: Section 703 should apply to holders of non-renounceable as well as renounceable options convertible into the bid class securities.

Non-registered holders

3.16 Another limitation of s 703 is that, in general, only those holders of non-bid securities who are registered as holders at the time of service of the s 703(4) notice, and remain registered, may give notice under s 703(8) requiring that these securities be bought out.¹²⁸ A purchaser of non-bid securities during or after a takeover bid can obtain the benefit of s 703 only through contractual arrangements with the registered vendor.¹²⁹

Issue: Should persons who are entitled to be registered as holders of non-bid securities at the time of service of the s 703(4) notice, whether or not they later become registered, be entitled to invoke the acquisition rights under s 703(8)?

¹²⁸ *Kingston v Ke prose Pty Ltd (No 3)* (1987) 12 ACLR 609. According to Hope JA: "If a person buys options at a time when he knows he may be locked in if a current take-over bid is successful, there seems to be no reason why the legislation should protect him against a difficulty [lack of rights under s 703] the risk of which he knowingly accepted and against which, as I will suggest, he could have protected himself by contract" (at 619). A possible exception may be securities "subject to transmission on death or possibly other events" (at 620). A possible "other event" is where the beneficial holder is entitled to be registered long before the takeover scheme was announced: *Mercantile Mutual Life Insurance Co Ltd v Atraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 586-87. D Grave, *supra* note 4 at 257, argues that it is difficult to justify precluding persons who obtain a right to become registered as holders before dispatch of a s 703(4) notice, or only obtain such a right after dispatch of the notice, from requiring the offeror to proceed with the acquisition under s 703(8).

¹²⁹ "The contract of purchase could leave the seller as the registered holder and require him to exercise the [s 703(8)] right on the buyer's behalf. There is nothing in the [Corporations Law] to give the beneficial owner an entitlement to exercise the right given by [s 703(8)], but likewise there is nothing which requires the registered holder to be the beneficial owner if he is to exercise that right": *Kingston v Ke prose Pty Ltd (No 3)* (1987) 12 ACLR 609 at 619, per Hope JA.

Submissions

3.17 The submissions were divided on giving such persons the right to invoke buy-out rights.

3.18 One respondent supported granting this right to promote simplicity in commercial transactions. Currently, purchasers of non-bid securities can reserve their ability to invoke those buy-out rights by arrangement with the vendor. In consequence, the purchaser can already exercise that right and for simplicity this should be explicitly recognised in the Corporations Law.¹³⁰

3.19 Another respondent opposed the proposal, pointing out that such persons would have acquired the non-bid securities with full knowledge of the takeover bid and therefore should bear the consequences of their actions.¹³¹ The SIA also commented that the policy of Chapter 6 is that the bidder should have to deal with registered holders. Beneficial owners have other contractual rights.

Legal Committee response

3.20 The Legal Committee elsewhere recommends that the right of buy-out under s 703 should be limited to remaining securities of the bid class and any other securities convertible into the bid class.¹³² It considers that persons holding equitable interests in these securities should not have rights additional to those they may have to require the registered holder to invoke the acquisition rights.

Recommendation 21: Persons who are entitled to be registered as holders of securities convertible into the bid class securities at the time of service of the s 703(4) notice should not be entitled to invoke the acquisition rights under s 703(8). This right should remain with the registered holders of those securities.

¹³⁰ Corrs *Submission*.

¹³¹ Rosenblum *Submission*.

¹³² Recommendation 17, *supra*.

Independent expert's report

3.21 The bidder is obliged to give a notice of entitlement within one month after the close of the offer period.¹³³ A bidder who proposes terms for acquisition of non-bid securities in the s 703(4) notice must include an independent expert's report on whether those terms are fair and reasonable.¹³⁴ Possibly, this obligation could be avoided by not proposing terms in the s 703(4) notice.¹³⁵ An intending vendor may apply to the court for alternative terms of acquisition.¹³⁶

Issue: Should an offeror, or any associate of the offeror, who proposes to acquire eligible non-bid securities where the prerequisites in s 703(4) have been satisfied, be required to send an independent expert's report with the proposal, where the proposed terms of acquisition are not set out in the s 703(4) notice?

¹³³ s 703(1), (4).

¹³⁴ s 703(5); ASC Policy Statement 75 and ASC Practice Note 42.

¹³⁵ In *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 576-7, Jacobs J questioned whether the obligation could be avoided, at least where a later offer to acquire these securities was made by an alter ego of the original bidder.

¹³⁶ Subsections 703(3) and (8) give the court a very wide discretion to consider any matter not extraneous to the purposes of the Corporations Law. An expert's report is not binding upon a court: *Kingston v Keprose Pty Ltd (No 2)* (1987) 12 ACLR 599. The court in that case held that:

- . the notion of equal opportunity does not mean that the terms of acquisition from the holders of options should be tested predominantly, or exclusively, by reference to the terms of the takeover offer
- . it was appropriate to give greatest weight to fair value judged at the date that the intending vendor gave notice
- . the price fixed in this case should be the value of the options if there had not been a takeover, therefore excluding any depressing effects of the takeover on the price.

In *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569, the court agreed that settling the terms of the acquisition calls for an exercise of intuitive judgment and judicial discretion which is not possible to expound as a reasoned process. It held that the terms on which non-voting preference shareholders should be paid should not be dictated solely by the market, given the depressing effect on their value arising from the successful takeover bid (applying *Kingston v Keprose Pty Ltd*). See further Renard & Santamaria, *supra* note 4 at [1214].

Submissions

3.22 Submissions generally supported an independent expert's report accompanying the proposal.

3.23 One submission argued that it is inconsistent that an expert's report on whether the terms are fair and reasonable is required if the terms are set out by the offeror in the notice required by s 703(4), but no expert's report is required if those terms are set out in a separate notice or offer.¹³⁷ The SIA also argued that holders of non-bid securities in a company now controlled by the bidder need the comfort of an independent valuation.

3.24 The Law Council did not fully support this requirement. It said it is unreasonably onerous to require the offeror to procure an independent expert's report where no terms and no compulsion by the offeror are proposed. It would, however, be appropriate to close the present loophole in s 703(5), which allows an offeror to avoid the requirement for an independent expert's report where buy-out terms are proposed, if those terms are not set out in the s 703(4) notice, but are set out elsewhere.

Legal Committee response

3.25 The Legal Committee considers that an offeror who proposes buy-out terms for any non-bid securities coming within s 703¹³⁸ should send an independent expert's report with that proposal, regardless of whether the terms are set out in the s 703(4) notice.

Recommendation 22: An offeror who proposes buy-out terms for any non-bid securities coming within s 703 should send an independent expert's report with that proposal, regardless of whether the terms are set out in the s 703(4) notice.

¹³⁷ Corrs Submission.

Other matters

3.26 One respondent pointed to a timing conflict between ss 701 and 703. Subsection 701(2) allows an offeror to dispatch a compulsory acquisition notice up to 2 months after the end of the offer period. However, s 703(1) requires an offeror to give notice to holders of remaining shares before the end of one month after the end of the offer period. This time difference can create very different consequences, given that s 703(3) enables remaining shareholders to seek an appraisal of the value of their shares, rather than compel them to receive the price payable under the takeover.¹³⁹

Legal Committee response

3.27 The Legal Committee considers that the time periods in ss 701 and 703 for sending notices should be consistent. The period in each case should be two months.

Recommendation 23: Subsection 703(1) should be amended to increase the time period for sending a notice from one month to two months.

Share acquisitions under s 414

Current law

4.1 Section 414 provides a procedure for approving a scheme or contract for the transfer of shares in a company. The scheme may involve the compulsory acquisition of minority shareholdings. Alternatively, the minority shareholders will have buy-out rights. Section 414 is the counterpart of ss 701 and 703 where a formal

¹³⁸ Note Recommendation 17, *supra*, to restrict the right of buy-out under s 703 to remaining securities of the bid class and other securities convertible into the bid class.

¹³⁹ Freehill *Submission*.

takeover bid under Chapter 6 is either not required or not currently possible without modification. It may be used where:

- the bid is for a company with 15 or fewer members¹⁴⁰
- a bid is for a class of non-voting shares,¹⁴¹ or
- a bid is made by an offeror who is already entitled to 90% or more of the target's voting shares.¹⁴²

Like s 701, the section does not apply to options and convertible securities.

4.2 The restrictions in s 615 apply to transactions under s 414.¹⁴³

Legal Committee view

4.3 The Legal Committee considers that, given its other recommendations, s 414 should be repealed. Taking each of the circumstances in para 4.1 in turn, the Legal Committee considers that:

- the compulsory acquisition powers should not apply to companies with fewer members than the Chapter 6 membership threshold. These powers could be abused in smaller proprietary companies. There are other recognised methods of resolving disputes, or buying out minorities, in these companies

¹⁴⁰ Bids for these smaller companies are exempt from the takeover obligations: s 619(1)(a).

¹⁴¹ A bidder may, however, choose to use the Chapter 6 procedure: see ASC Practice Note 8.

¹⁴² An ASC modification of s 701(2)(b) would be required to permit the bid to proceed under s 701: ASC Practice Note 8.

¹⁴³ The exemption in s 625 from the application of s 615 only applies to compromises or arrangements approved by the Court under Part 5.1. A s 414 arrangement does not require court approval.

- the Chapter 6 procedure should be available for bids relating to any class of securities¹⁴⁴
- a person who has the full beneficial interest in at least 90% of any class of securities could employ the new compulsory acquisition procedure.¹⁴⁵ Persons with a 90% or greater entitlement, but falling short of the 90% full beneficial interest in any class of securities, could either undertake a Chapter 6 bid for the outstanding securities of that class,¹⁴⁶ or acquire securities in that class in any manner¹⁴⁷ to reach the compulsory acquisition threshold under the new procedure.

Recommendation 24: Section 414 should be repealed.

4.4 In Appendix 3, the Legal Committee sets out various recommendations for reform of s 414 if, contrary to this recommendation, the section is retained.

¹⁴⁴ See Recommendation 2, *supra*.

¹⁴⁵ See paras 10.1 ff.

¹⁴⁶ Recommendations 5 and 7, *supra*.

¹⁴⁷ The restrictions on acquisition of voting shares in s 615 do not apply to a person who is already entitled to 90% of those shares. Also, s 615 does not apply to securities other than voting shares.

Selective capital reductions

The rules governing selective capital reductions are currently being considered in the Corporations Law Simplification Program.¹⁴⁸ At the time of finalising this Report, the proposed rules for share capital reductions had not been settled. The Legal Committee considers that any amendments should not permit these reductions to be used for compulsory acquisitions in any manner that could reduce the protections otherwise available under the existing compulsory acquisition powers (as proposed to be amended in this Report) or under the proposed new compulsory acquisition procedure.

Amendment of articles: s 176

This matter is now regulated by the High Court decision in *Gambotto*. The Legal Committee does not propose any amendment to the *Gambotto* principles as they apply to the alteration of a company's articles of association to permit a compulsory acquisition.¹⁴⁹

Schemes of arrangement: s 411

Current law

5.1 A scheme of arrangement may involve minority shares or other securities being cancelled in exchange for the issue of securities in another entity (usually shares, notes or options in the offeror) or for a cash consideration.¹⁵⁰ Currently, any scheme

¹⁴⁸ In consequence, this Report does not deal with Issues 36-38 and 47 of the Issues Paper.

¹⁴⁹ In consequence, this Report does not deal with Issues 39-43 of the Issues Paper.

¹⁵⁰ S Traves, *A Scheme of Arrangement Can Be an Effective Method of Takeover* (1994) 12 C&SLJ 32 at 44-5 describes a scheme of arrangement which results in a transfer of control as commonly taking the following form:

- . all the shares in the target company, other than those held by the bid company, are cancelled

involving cancellation of shares must also comply with the share capital reduction provisions.

5.2 The s 411 scheme procedure involves extensive statutory disclosure requirements, advance notification to the ASC and court supervision from the outset. In summary:

- *Explanatory statement.* The court must approve an explanatory statement under s 412.¹⁵¹ The purpose of the statement is to inform the members about the purpose and likely effect of the proposed scheme and any material interests of directors. An independent expert's report may also be required.¹⁵²
- *Class meetings.* Where more than one class of members is involved, separate meetings must be held and separate approvals obtained. The concept of "class of members" in s 411 is not defined in the legislation, but is left to common law principles.¹⁵³ Persons whose

-
- the reserve thus created is used for issuing further paid-up shares in the target company to the bid company
 - shares in the bid company are issued to the shareholders in the target company as compensation for the cancellation of their shares.

¹⁵¹ Schedule 8 of the Corporations Regulations sets out the prescribed information referred to in s 412(1)(a)(ii). Part 3 of Schedule 8 sets out the prescribed information for a compromise or arrangement with members. Some prescribed information is similar to that required for a Part A statement. The leading case on the necessary level of disclosure is *Phosphate Co-operative Co of Australia Ltd v Shears (No 3)* (1989) 14 ACLR 323, analysed in R Nicholson, *The Pivot Case - New Standards for Schemes of Arrangement* (1989) 7 C&SLJ 277. In *Re W Coogan & Co Pty Ltd* (1993) 10 ACSR 461, the parties failed to seek a prior court order for calling the meetings or the approval of the explanatory statement. The court declined to cure these defects under s 1322(4)(a).

¹⁵² See ASC Policy Statement 75 para 8.

¹⁵³ In *Re Stockbridge Ltd* (1993) 9 ACSR 637, the Court confirmed that in the context of schemes of arrangement, it is proper to treat option holders as creditors rather than as members. See also *Re Austamax Resources Ltd* (1985) 10 ACLR 194; *Re BDC Investments Ltd* (1988) 13 ACLR 201; *Re US Masters Ltd* (1991) 4 ACSR 462. Under general

shares will be expropriated may form a different class from remaining shareholders.

- *Requisite majorities.* The necessary majorities under s 411 are 75% in value and a simple majority in number of those present and voting in person or by proxy at each class meeting.
- *Non-avoidance.* Subsection 411(17) provides that the court shall not approve a s 411 compromise or arrangement unless it is satisfied that the scheme has not been proposed to enable a person to avoid the operation of Chapter 6 or unless the ASC has issued a written statement that it has no objection.

5.3 The court may not authorise an arrangement which is inconsistent with the Corporations Law or which has as a "substantial purpose" to avoid Chapter 6.¹⁵⁴ Subject to that, there is no assumption that the takeover provisions in Chapter 6 should be preferred to the scheme provisions of Chapter 5, nor will a scheme be disapproved merely because it displays some characteristics of a takeover.¹⁵⁵ Rather, a court will consider the Chapter 5 and Chapter 6 provisions together, and subject them to the same principles of full disclosure and fairness to shareholders.¹⁵⁶ A court is not bound to approve a scheme simply because it earlier granted leave to convene the meetings or because requisite majorities of members or creditors agreed to it.¹⁵⁷ Dissenting members or creditors may make submissions opposing the approval on grounds which may include new

common law principles, a convertible noteholder would be a creditor for the purposes of s 411. See also ASC Practice Note 32.

¹⁵⁴ *ASC v Marlborough Gold Mines Ltd* (1993) 10 ACSR 230; *Re Stockbridge Ltd* (1993) 9 ACSR 637.

¹⁵⁵ *Re ACM Gold Ltd* (1992) 7 ACSR 231; *Re Stockbridge Ltd* (1993) 9 ACSR 637. An acquisition under a scheme of arrangement approved by the court is exempt from the takeover provisions: s 625. In *Re Stockbridge Ltd*, the Court ruled that a downstream acquisition pursuant to a scheme of arrangement comes within this exemption.

¹⁵⁶ *Re ACM Gold Ltd* (1992) 7 ACSR 231 at 240.

¹⁵⁷ *Re Stockbridge Ltd* (1993) 9 ACSR 637.

material not available to the court when leave to convene the meeting was granted.¹⁵⁸

ASC policy

5.4 These judicial principles have been adopted in ASC Policy Statement 60 which identifies the circumstances where the Commission will provide a "no objection" statement to the court. The ASC recognises that persons should not be required to follow the Chapter 6 procedures in preference to other methods of acquisition. Many outcomes which cannot be effected under a Chapter 6 takeover, with or without modification, may be achieved under Chapter 5 or simultaneously with a Chapter 5 resolution. These include:

- compulsory acquisitions by a majority shareholder who is already entitled to 90% or more of the voting share capital¹⁵⁹
- compulsory acquisitions of options and convertible securities (sometimes simultaneously with shares)¹⁶⁰
- schemes that require a reduction of capital by the target company¹⁶¹
- acquisitions of more than one class of share or security.¹⁶²

¹⁵⁸ Ibid.

¹⁵⁹ An ASC modification of s 701(2)(b) would be required to permit this to proceed under Chapter 6: ASC Practice Note 8. See, however, Recommendation 5, supra, to permit Chapter 6 bids by persons who are already entitled to 90% or more of a class of securities.

¹⁶⁰ *Re Stockbridge Ltd*, (1993) 9 ACSR 637. Renard & Santamaria, supra note 4, para [1215] and [1515] refer to some uncertainty in the case law about whether renounceable options fall within s 411, and a lack of any High Court opinion on the matter.

¹⁶¹ *Re ACM Gold Ltd* (1992) 7 ACSR 231 at 243-4; *Re Stockbridge Ltd* (1993) 9 ACSR 637.

5.5 The ASC Policy Statement sets out detailed guidelines for the conduct of shareholders' meetings, including the information to be provided to members,¹⁶³ the terms of resolutions where there are separate classes of members, and the principles for determining the fairness of any differences in consideration offered for each class of share or other security. The ASC will look to the disclosure requirements in Pt A of s 750 and the principles in s 731 when considering the level of disclosure under any scheme of arrangement which is capable, in whole or part, of being effected as a takeover scheme.

5.6 Persons who hold target shares or other securities which are not to be cancelled are not precluded by statute from voting on the scheme, though they may form a separate class. In any event, the ASC takes the view in its Policy Statement that to demonstrate fairness:

- the interests of these parties should be fully disclosed, and
- these parties should decline to vote on the resolution to approve the acquisition.

Where these interested parties do vote, a record should be kept to assist the court in determining whether to approve the scheme.

5.7 Overall, in determining whether to object under s 411(17), the ASC will consider whether the shareholders are, on the whole, adversely affected by the compulsory acquisition being implemented by a scheme of arrangement, rather than a Chapter 6 bid. The ASC will not intervene if:

- it has no concerns regarding the disclosure of all material information

¹⁶² This is not possible under a single Chapter 6 takeover bid, which is restricted to an offer to the holders of one class of shares (Corporations Law ss 634, 674) unless the ASC grants a modification.

¹⁶³ See also ASC Policy Statement 75 and ASC Practice Note 43 concerning experts' reports, and valuation and profit forecast reports.

- the treatment of members is consistent with the Eggleston principles (s 731), and
- there has been proper compliance with the procedures for the conduct of meetings.

Consideration of issues

Issue: Should s 411 be amended to place beyond doubt that it applies to compulsory acquisitions of both renounceable and non-renounceable options as well as convertible notes and shares?

Submissions

5.8 Submissions favoured the provision applying to both renounceable and non-renounceable options, in the interest of promoting commercial certainty. The Law Council submission drew attention to various judicial remarks on the need for this reform.¹⁶⁴

Recommendation 25: Section 411 should be amended to place beyond doubt that it applies to compulsory acquisitions of both renounceable and non-renounceable options as well as convertible notes and shares.

Issue: Should the requisite majorities in s 411, namely 75% in value and 50% in number of those present and voting, be altered for a scheme involving a compulsory acquisition of securities?

Submissions

5.9 The submissions generally opposed any alteration to the 75% in value and 50% in number requirement.

5.10 One respondent was concerned that any change might affect the flexibility of proceedings under Chapter 5, which is its key

¹⁶⁴ See *Re BDC Investments Ltd* (1988) 6 ACLC 85; *Re BDC Investments Ltd* (1988) 13 ACLR 201 at 203.

benefit.¹⁶⁵ The ASC pointed out that it is implicit that the s 411 proposal should be recommended by the board of the target company and receive court sanction. It is therefore not necessary to impose the same majorities as those required in s 701. The Law Council also opposed any alteration.

Legal Committee response

5.11 The Legal Committee considers that given the procedural protections in s 411, it is not necessary to apply the same compulsory acquisition threshold test as in s 701.

Recommendation 26: There should be no alteration to the current requisite majorities in s 411 for a scheme involving a compulsory acquisition of securities.

Issue: Should persons whose shares or other securities are not to be cancelled (remaining shareholders) be expressly excluded from voting in a compulsory acquisition scheme of arrangement?

Submissions

5.12 Submissions did not support remaining shareholders being expressly excluded from voting.

5.13 The ASC argued that to disenfranchise remaining shareholders would open opportunities for holders of shares to be cancelled (departing shareholders) to impose their own terms on a scheme of arrangement. The SIA did not support any exclusion, but commented that segregation of voting between remaining shareholders and departing shareholders would still be useful for the court.

¹⁶⁵ Corrs *Submission*.

Legal Committee response

5.14 The Legal Committee notes that a scheme of arrangement involving the cancellation of shares will constitute a reduction of capital. The Second Corporate Law Simplification Bill proposes new rules to ensure that any reduction is fair and reasonable to all the company's shareholders.¹⁶⁶ The Legal Committee considers that no further controls are required in s 411.

Recommendation 27: Section 411 should not prohibit any shareholders from voting on a compulsory acquisition scheme of arrangement.

Amalgamations: s 413

6.1 Section 413 empowers the court to make orders in connection with a s 411 scheme to merge two companies. This may involve the transfer of the whole or part of the undertaking and the property or liabilities of the transferor company. A parent corporation can effectively eliminate minority holdings in its subsidiary by a s 413 amalgamation whereby the minority holders are compensated under a related s 411 compromise or arrangement. The court, however, may make special provision "for any persons who, within such time and in such manner as the Court directs, dissent from the compromise or arrangement".¹⁶⁷

Issue: Does s 413 sufficiently protect dissenting minorities?*Submissions*

6.2 Submissions argued that the section does sufficiently protect dissenting minorities. Section 413 only applies where a s 411 scheme of arrangement is on foot. Appropriate protections for dissenting minorities are included in s 411.

Legal Committee response

¹⁶⁶ Exposure Draft of the Second Corporate Law Simplification Bill s 256A(1)(a).

¹⁶⁷ s 413(1)(e).

6.3 The Legal Committee considers that the current s 413 sufficiently protects dissenting minorities. It would be inappropriate for further protections to be inserted into that section.

Recommendation 28: There should be no amendment to s 413.

Selective share buy-backs

The share buy-back provisions were amended by the First Corporate Law Simplification Act 1995.¹⁶⁸ The buy-back powers cannot be used to compulsorily acquire minority shareholdings. They have no implications for the compulsory acquisition powers discussed in this Report.

Voluntary liquidation and selective distribution in specie: s 501

7.1 Minority interests can be eliminated through a voluntary winding up in which the majority shareholder receives the main undertaking of the company with a commensurate cash distribution to minority shareholders. This form of distribution is not permitted unless provided for in a company's constituent documents. It also requires shareholders to pass a special resolution to appoint a liquidator to wind up the affairs of the company and to distribute the property. The liquidator must act fairly in adjusting the rights of the contributories among themselves.¹⁶⁹ Minority shareholders may challenge this procedure by appealing from the decision of the liquidator¹⁷⁰ or seeking to remove the liquidator on the ground of unfitness to act.

¹⁶⁸ In consequence, this Report does not deal with Issue 49 of the Issues Paper.

¹⁶⁹ s 506(3). The liquidator may convene a general meeting to approve the proposed distribution by special resolution: s 506(1)(f).

¹⁷⁰ s 1321.

Issue: Should there be specific disclosure requirements for voluntary liquidation resolutions where the company's constituent documents permit a selective distribution in specie?

Submissions

7.2 Submissions did not favour specific disclosure requirements for voluntary liquidation resolutions.

7.3 The AICD pointed out that significant protection is already afforded to minorities through the involvement of a liquidator, who must comply with legislative and common law duties. The ASC also argued that the involvement of a liquidator should ensure that minority shareholders are not unfairly treated in the distribution of company assets. Other submissions argued that the general requirements as to informed consent were sufficient.

Recommendation 29: There should be no specific disclosure requirements for voluntary liquidation resolutions where the company's constituent documents permit a selective distribution in specie.

Issue: Should persons who are eligible to receive selective distributions in specie, and their associates, be precluded from voting on the voluntary liquidation resolution?

Submissions

7.4 Submissions did not support any persons being precluded from voting on a voluntary liquidation resolution.

7.5 The Law Council noted that this might exclude all shareholders from voting on the resolution. Other submissions pointed out that the liquidator would have to comply with fiduciary obligations in exercising any power to make selective distributions in specie.

Recommendation 30: The Corporations Law should not prohibit persons who are eligible to receive selective distributions in specie, and their associates, from voting on the voluntary liquidation resolution.

Issue: Should individual shareholders have further rights to challenge selective distributions in specie?

Submissions

7.6 A majority of submissions did not support any further rights of challenge, given the obligations on the liquidator.

Legal Committee response

7.7 The Legal Committee considers that shareholders have sufficient remedies, for instance, under s 260.

Recommendation 31: Individual shareholders should not have further rights to challenge selective distributions in specie.

Voluntary liquidation - amalgamation: s 507

8.1 The liquidator of a company, with a special resolution of shareholders, may arrange to transfer the whole or part of the company's business or property to another corporation, in return for the members of the company in liquidation receiving securities in the acquiring corporation.¹⁷¹ In contrast to an amalgamation under s 413 involving a s 411 scheme, the approval of the court or the minority holders as a separate class is unnecessary. However, members who dissent from the special resolution may require the liquidator to buy their shares at a price determined by agreement or arbitration in the event that the

¹⁷¹ Share acquisitions made under an arrangement entered into by a liquidator under s 507 are exempt from the takeover provisions: s 626.

liquidator wishes to implement the proposal.¹⁷² A minority shareholder can therefore "opt-out" of the proposal, without the relevant amalgamation being defeated.

Issue: Should there be any specific disclosure requirements for any asset transfer resolution under a voluntary liquidation?

Submissions

8.2 The majority of the submissions argued that the common law principles of informed consent should suffice. Also, the liquidator is obliged to act fairly and reasonably.

Recommendation 32: There should be no specific disclosure requirements for any asset transfer resolution under a voluntary liquidation. These matters should be left to the common law.

Issue: Should any member of the company who is the intended transferee of the company's business or property or an associate of the transferee be precluded from voting on the resolution?

Submissions

8.3 Submissions were divided on whether to preclude these persons from voting on the resolution.

8.4 Several submissions favoured the exclusion of these members.¹⁷³ The SIA argued that this situation can be distinguished from the similar Issue in relation to s 501¹⁷⁴ as it relates to the sale decision, rather than the decision to liquidate. Another respondent suggested requirements similar to those in Rule 3J(3) of the ASX Listing Rules.¹⁷⁵

¹⁷² s 507(4).

¹⁷³ ASC *Submission*; SIA *Submission*; Law Council *Submission*; Corrs *Submission*.

¹⁷⁴ Refer paras 7.4, 7.5 and Recommendation 30.

¹⁷⁵ Corrs *Submission*.

8.5 One submission argued against the exclusion, stating that the minority shareholder who dissents is sufficiently protected by being entitled to be bought out at a fairly determined price.¹⁷⁶

Legal Committee response

8.6 The Legal Committee supports parties who will receive property under a transfer having restricted voting rights. They may vote against, but not in favour of, the transfer.

Recommendation 33: Any transfer of a company's business or property under a voluntary liquidation should require the consent of shareholders by special resolution, with no votes being cast in favour of the resolution by any intended transferee or any associate of the transferee.

Sale of assets and liquidation

9.1 Instead of eliminating minority interests, a majority shareholder may acquire the main undertaking of the target company. The board of directors must comply with their common law and statutory duties in reaching any decision to sell these corporate assets. In addition, listed companies must comply with ASX Listing Rules 3J(3) and 3S(2), which require that the sale be approved by an ordinary resolution of shareholders, excluding interested parties. The minority shareholders in a listed company can therefore veto the sale. Where the acquiring shareholder is itself listed on the ASX, it may also need to obtain the approval of its shareholders under Listing Rule 3J(3).

Issue: Should the restrictions on sale of assets in the ASX Listing Rules be included in the Corporations Law? If so, should similar restrictions apply to unlisted public companies?

¹⁷⁶ Rosenblum *Submission*.

Submissions

9.2 Submissions did not support further specific rules being included in the Corporations Law.

9.3 The ASC observed that a majority shareholder will be a parent entity in relation to a target company within the meaning of s 243D. The sale of the main undertaking of the target company to the majority shareholder constitutes the "giving of a financial benefit" within the meaning of s 243G. The Commission stated that if either the majority shareholder or the target company is a public company, the transaction will be regulated by Pt 3.2A Div 2 of the Law. These provisions require, in effect, that the non-interested shareholders must approve the transaction by ordinary resolution after proper disclosure of all relevant information relating to the transaction. Given these provisions, there is no need to introduce additional provisions similar to the listing rule.

9.4 The AICD also pointed to the statutory protections of ss 232 and 260 of the Corporations Law.

9.5 The SIA argued that the sale of the main undertaking is sufficiently serious (having the practical effect of expropriation) that the restrictions in the ASX Listing Rules should arguably apply to all companies via the Corporations Law. However, shareholders have the existing protections, for instance under directors' duties, oppression, etc. In addition, companies are free to insert restrictions in their articles of association that have the same effect. The SIA therefore did not support any restrictions in the Corporations Law.

9.6 The Law Council also opposed any such restriction in the Corporations Law. It noted that the possibility of imposing restrictions was contemplated by the original exposure draft of the Corporate Law Reform Bill 1992 but was not subsequently adopted.

Recommendation 34: The restrictions on sale of assets in the ASX Listing Rules should not be included in the Corporations Law.

New compulsory acquisition power

10.1 The Legal Committee proposes a new compulsory acquisition power in addition to those already dealt with in this Report. The new power would involve a simplified procedure, available for any class of securities, and without the specific prerequisites for using the other compulsory acquisition powers, such as a recently completed successful Chapter 6 bid for the class of securities or court approval of a s 411 scheme of arrangement. It would assist a controlling entity to achieve the legal and economic advantages of full ownership, ensure equal and fair treatment of minorities and reduce the opportunity for greenmailing.

The November 1994 proposal

10.2 In November 1994, the Legal Committee published a proposal to permit a shareholder with a minimum 90% voting entitlement to compulsorily acquire all remaining shares through an offer to minority shareholders. Each offeree could either accept the offer and be paid the offer price or elect for a court determination of a fair price for dissidents.

Submissions

10.3 There was a mixed reaction to the proposal. The SIA and IBSA opposed the new compulsory acquisition power, particularly if it attempted to substitute a court-determined buy-out price for a market-based price. The Australian Shareholders' Association favoured a higher than 90% threshold in some instances. Other submissions supported the principle of a simplified general compulsory acquisition power, though not as a substitute for existing provisions. These submissions also raised concerns about the proposed procedure, in particular:

- the disincentive for minority shareholders to challenge the offer price through litigation
- the possible unequal treatment between dissenting and non-dissenting minority shareholders
- whether it was appropriate for courts to determine specific acquisition prices in cases of dispute
- the inability of the controlling shareholder to determine the potential total acquisition cost from the outset.

Legal Committee response

10.4 The Legal Committee resolved to develop a new proposal in lieu of the November 1994 proposal, taking into account all concerns raised in the submissions.

Outline of new proposal

10.5 A 90% or more controlling entity of any class of securities could compulsorily acquire remaining securities of that class by means of an offer to all holders of those securities, subject to the entity obtaining court approval of the acquisition if a minimum number of holders dissent.¹⁷⁷ The key elements of this procedure are:

- the controlling entity could make an unconditional cash offer to acquire all the remaining securities of a class
- the offer would have to be accompanied by at least one independent expert's report on whether it is for fair value
- the controlling entity would have to compulsorily acquire all the securities pursuant to the terms of the offer if fewer than 10%, by value, of the remaining holders dissent

¹⁷⁷ One view in the Advisory Committee is that the Corporations and Securities Panel should have this approval power because of possible reduced costs and the commercial expertise of Panel members. The Legal Committee favours the court having the approval power. It considers that the Panel is more suited to making prompt commercial decisions on urgent matters. Fair valuation may take longer to determine.

- . the controlling entity would have to either withdraw the offer or seek a court order for compulsory acquisition pursuant to the terms of the offer if 10% or more, by value, of the remaining holders dissent
- . the court could only approve or not approve a compulsory acquisition for all remaining holders
- . a controlling entity who compulsorily acquired the remaining securities of a particular class would also have to offer to buy out the holders of all securities convertible into that class.

10.6 The new proposal differs from the November 1994 proposal in that:

- . the new procedure could be used for any class of securities
- . the offer could not be selectively accepted: it would either succeed or fail for all holders
- . the offer price would remain the same for dissidents and non-dissidents
- . the obligation would be on the controlling entity, not dissenting offerees, to commence court proceedings if sufficient offerees dissent
- . a court could not determine a different acquisition price
- . any dissident who chose to be a party to a court approval proceeding would have a *prima facie* entitlement to costs and could not be required to meet the costs of the controlling entity.

Comparison with other procedures

10.7 The new procedure would be additional to other methods of compulsory acquisition. It would differ from compulsory acquisitions under s 701 as follows.

- . *Compulsory acquisition threshold.* The new procedure would have a 90%, by value, "full beneficial interest"

threshold, rather than the 90% (or greater) "entitlement" threshold proposed for s 701.¹⁷⁸

- *Rights of dissidents.* The new procedure would require the controlling entity to obtain court approval of its compulsory acquisition offer if a minimum number of remaining holders dissent. The onus would be on the controlling entity to establish that the offer price was fair. By contrast, under s 701, the onus falls on dissidents to challenge a compulsory acquisition. Any successful challenge relates to their own securities only. The difference in approach follows from compulsory acquisitions under s 701, but not under the new procedure, depending on, and being required to have the same terms as, a recently completed takeover bid which has been overwhelmingly accepted by offeree holders.

10.8 The Committee has elsewhere recommended the repeal of s 414.¹⁷⁹ However, it sees no inconsistency between the new proposal and s 411 schemes of arrangement,¹⁸⁰ given the procedural protections, including court supervision, for these schemes.

10.9 At the time of finalising this Report, the proposed reform of the rules governing share capital reductions had not been settled. The Legal Committee considers that any reforms to this procedure should not permit share capital reductions to be used for compulsory acquisitions in any manner that could provide less protection than under the proposed new compulsory acquisition procedure.

Ambit of new proposal

10.10 This procedure would apply to all public companies and proprietary companies with more than the minimum Chapter 6

¹⁷⁸ cf Recommendation 7, and note 69, supra.

¹⁷⁹ Recommendation 24.

¹⁸⁰ paras 5.1 ff.

threshold membership,¹⁸¹ regardless of any contrary provision in their articles of association. The Legal Committee considers that to permit the articles to prohibit compulsory acquisition could be too inflexible. Articles with such a prohibition could only be amended where all shareholders consent or in other limited circumstances.¹⁸² However, individual shareholders could enter into shareholder agreements concerning their exercise of the new compulsory acquisition power. These agreements would only bind the parties to them.

10.11 The compulsory acquisition procedure would not apply to company title units.

Ability to compulsorily acquire securities

10.12 The new procedure could be used by any entity who holds, either alone or with any entities subject to the same ultimate ownership,¹⁸³ a full beneficial interest in at least 90% by value of any class of securities. That entity may offer at any time to acquire the remaining securities of that class. This beneficial interest requirement would overcome any possibility of a person relying on an artificial entitlement to help satisfy the test of being a controlling entity.¹⁸⁴

10.13 A person with a 90% entitlement to a particular class of securities, but not amounting to a 90% full beneficial interest, could acquire further securities in that class in any manner to reach the beneficial interest threshold.¹⁸⁵

¹⁸¹ Under s 619(1)(a), the membership threshold for a company to be subject to Chapter 6 takeover regulation is 15 members. The Simplification Task Force is proposing that this threshold be increased to 50 members.

¹⁸² *Gambotto v WCP Ltd* (1995) 127 ALR 417.

¹⁸³ This is intended to cover any entities under 100% common ownership.

¹⁸⁴ For instance, an artificial entitlement may arise under s 33 or through pre-emption rights, as in *North Sydney Brick & Tile Co Ltd v Darvall (No 2)* (1986) 10 ACLR 837.

¹⁸⁵ The Chapter 6 restrictions on acquisitions only apply to acquisitions of voting shares up to the 90% entitlement: s 615(1).

10.14 There would be no power to reduce the 90% full beneficial interest threshold. This contrasts with the Legal Committee recommendation on s 701.¹⁸⁶ This difference in approach stems from the new procedure, unlike s 701, not depending on a recently completed successful takeover bid.

Right to compulsorily acquire

10.15 There would be no "proper purpose" requirement for compulsory acquisitions under the new procedure. The *Gambotto* principles would not apply. Likewise, none of the specific prerequisites of the other compulsory acquisition powers would apply.

Notification of offer

10.16 A controlling entity would initiate the compulsory acquisition procedure by circulating, at its own cost, an identical offer to all remaining holders of a particular class of securities to acquire the securities at a specific price. The offer could not be selective or conditional.

10.17 The notice to remaining holders would have to explain the compulsory acquisition procedure¹⁸⁷ and state that holders could obtain the names and addresses of other remaining holders of that class from the relevant company register.

10.18 A copy of the offer would have to be served on the company and lodged with the ASC, for publication on its database. However, the controlling entity would not be obliged to advertise the offer in any newspaper.

10.19 Whether a controlling entity should be required to inform the ASX of any matter related to the compulsory acquisition offer should be left to the Listing Rules.

¹⁸⁶ Recommendation 8, *supra*.

¹⁸⁷ The terms of this explanation could be prescribed under the Corporations Regulations.

Fair value disclosure

10.20 The controlling entity, at its own cost, would have to commission at least one independent expert's report on whether the offer for the relevant class is for fair value. All commissioned reports would have to be lodged with the ASC for publication on its database and be forwarded with the offer to remaining holders.¹⁸⁸ The controlling entity could proceed even if an independent expert's report stated that the offer price was not fair.

10.21 There should be some non-exhaustive legislative guidance for independent experts on determining fair value in these compulsory acquisitions, given the current uncertainty in the case law. These criteria should be similar to those for compulsory acquisitions under s 701. In determining fair value, an independent expert should:

- . assess the value of the company as a whole and determine the value of each class of issued security, taking into account its relative financial risk and its distribution rights
- . expressly disregard whether the remaining securities of the offer class should attract a premium or discount.

These fair value criteria would apply to compulsory acquisitions, but not necessarily to other circumstances involving valuation of securities.

Other disclosure

10.22 In some instances, an independent expert's report might not by itself provide full and complete information relevant to determining fair value. If and only if this occurred, the controlling entity would also have to include with the offer a disclosure statement, containing any information which was:

- . available to the controlling entity
- . not contained in any independent expert's report, and

¹⁸⁸ cf s 703(6).

- material to remaining holders in assessing the fair value of the offer for that class of securities.

A copy of any disclosure statement would have to be lodged with the ASC.

Cash offer

10.23 The controlling entity could only offer cash. This would overcome the problem of assessing the fairness of a scrip offer. No consideration could be paid until the compulsory acquisition process for that class had been completed.

Minimum cash offer

10.24 The offer would be subject to a four month "relation-back" rule. Where the controlling entity, or any associate, had acquired, or had agreed to acquire, any securities in the relevant class (whether under a formal bid or otherwise) in the four months prior to dispatch of its offer, the offer would have to be no less than the highest price paid, or agreed to be paid, for those securities.¹⁸⁹ However, the minimum offer would not necessarily satisfy the fair value requirement.

10.25 The ASC should have a discretion to permit a lower offer than under the relation back rule where intervening events materially reduce the fair value of the securities.¹⁹⁰

Increased offer price

10.26 A controlling entity could increase the buy-out price only by making a new offer to all holders of the relevant class. A new offer for a higher cash price could be made at any time. It would automatically void any outstanding lower offer for that class. This would have to be disclosed in the notice accompanying the subsequent offer. This notice and the new offer documents,

¹⁸⁹ cf s 641(1)(c).

¹⁹⁰ cf s 641(1)(d).

including the disclosure statements, would have to be lodged with the ASC.

Withdrawal of offer

10.27 A controlling entity could at any time withdraw any outstanding offer to all holders of a class:

- . if 10% or more, by value, of remaining holders of that class notified their dissent, or
- . by making a higher priced offer for that class.

A controlling entity who withdraws an offer would have to notify all holders of that class within 7 days. A copy of that notice would have to be lodged with the ASC.

Prohibition on non-offer acquisitions and benefits

10.28 During the offer period, the controlling entity or any of its associates could not acquire, or agree to acquire, securities in that class, other than under the offer. This ban on privately negotiated prices would counter greenmailing by, or discrimination amongst, minority holders. A controlling entity should also be prohibited from providing or agreeing to provide any other benefits to an offeree.¹⁹¹

Minimum offer period

10.29 The minimum offer period would have to be stated in the offer and be no less than 30 days after dispatch of the offer. This would allow each holder to decide whether to dissent and thereby obtain standing in any subsequent litigation.

¹⁹¹ cf s 698, though the Legal Committee has elsewhere proposed that s 698(2) and (4) be repealed: Legal Committee Report: *Anomalies in the Takeovers Provisions of the Corporations Law*, 1994, Recommendation 39.

Method of dissent

10.30 Remaining holders of a class could dissent by completing and returning to the controlling entity within the offer period a dissent form which must accompany the offer. The controlling entity would have to lodge copies of any completed dissent forms with the ASC, for inclusion on the database. An election to dissent would be irrevocable.

Automatic compulsory acquisition if insufficient dissent

10.31 A controlling entity should not be permitted to withdraw an offer to a particular class (except by substitution of a higher priced offer) if fewer than 10%, by value, of the remaining holders of that class dissented. In this instance, the controlling entity must compulsorily acquire all the bid class securities pursuant to the terms of the offer. All remaining holders of that class, whether or not they dissented, would have to be notified of the compulsory acquisition and paid (if traceable) within 14 days after the close of the offer period. Unclaimed property provisions would apply.¹⁹²

Withdrawal or court approval if sufficient dissent

10.32 If 10% or more, by value, of the remaining holders of the class dissented within the offer period, the controlling entity must either:

- withdraw the offer to that class, or
- apply for court approval of the acquisition at the offer price

before the end of 21 days after the close of the offer period. In the latter case, the offer to all holders of that class would fail if the court did not approve the acquisition.

10.33 Failure by the offeror to apply to the court within the 21 day period would cause the offer to lapse. The controlling

¹⁹² cf s 702.

entity would have to notify all holders of that lapse within a subsequent 7 days, that is, within 28 days after the close of the offer period. A copy of that notice would have to be lodged with the ASC.

10.34 If court approval is sought, all remaining holders of that class, whether or not dissidents, would have to be notified of the application within 7 days. A copy of that notice would have to be lodged with the ASC. The notice would have to state that any dissident may choose to oppose the compulsory acquisition in the court approval proceedings on the grounds that the value of the offer to all remaining holders of that class was unfair. It should also outline the rules governing costs in these proceedings.¹⁹³ The notice should state that each dissident may obtain details of all other dissidents through the ASC database, or require the controlling entity to forward this information within 5 business days.

Power of the court

10.35 The court could only approve or not approve the compulsory acquisition pursuant to the terms of the offer for a particular class. It could not vary the offer price. This would provide price certainty. Assessment of the offer should be based on whether it is for fair value to all holders as at the date of the offer, taking into account the statutory fair value criteria for compulsory acquisitions.¹⁹⁴ The onus would be on the controlling entity to establish that the offer price was fair, whether or not any dissidents joined the action.

10.36 This approach would ensure that:

- . all remaining holders of a class are treated equally
- . the cost of the compulsory acquisition for a class of securities is fixed from the outset
- . the courts do not become involved in determining a specific acquisition price

¹⁹³ See paras 10.37 and 10.38, post.

¹⁹⁴ See para 10.21, supra.

- the courts apply consistent fair value criteria.

Court costs

10.37 The controlling entity would have to bear its own costs in seeking court confirmation.

10.38 The court should award costs to any dissident appearing on the application, unless it was satisfied that the dissident had acted improperly, vexatiously or otherwise unreasonably.¹⁹⁵ However, the court should have no power to order a dissident to pay all or part of the controlling entity's costs.

Retention of rights

10.39 Remaining holders of the offer class should retain their voting, dividend, disposal and other rights until completion of the compulsory acquisition process. However purchasers of these securities would take them subject to the compulsory acquisition offer. They would be bound by any previous exercise of the right to dissent from the offer. Conversely, if the right to dissent had not been exercised, the purchaser could only do so if the offer period had not expired.

Obligation to offer to acquire other securities

10.40 The Legal Committee elsewhere recommends that the rights of buy-out under s 703 should be limited to remaining securities of the bid class and any other securities convertible into the bid class.¹⁹⁶ The Legal Committee considers that a similar policy should apply to the new procedure. A controlling entity who successfully acquires all the remaining securities of a class by employing the new procedure would also have to offer to buy

¹⁹⁵ Contrast Recommendation 15, *supra*, regarding court costs in an application by dissidents under s 701.

¹⁹⁶ Recommendation 17, *supra*.

out holders of all securities convertible into that class. The buy-out offer should follow the s 703 procedure.

Appendix 1

List of respondents

Australian Institute of Company Directors

Australian Securities Commission

Australian Shareholders' Association

Corrs Chambers Westgarth

Freehill Hollingdale & Page

International Banks & Securities Association of Australia

James Andronis

Law Council of Australia

Rosenblum & Partners

Securities Institute of Australia

Appendix 2

List of recommended reforms to the existing provisions

Implications of *Gambotto v WCP Ltd*

Recommendation 1: Sections 414 (if retained) and 701 should be amended to put beyond doubt that:

- . they are not subject to any "proper purpose" limitation
- . the onus remains on dissidents.

It should be made clear that no disclosure additional to the Part A and Part C Statements should be required under s 701.

Acquisitions following a successful Chapter 6 bid: s 701

Recommendation 2: A person should be entitled to conduct a separate Chapter 6 takeover bid for any class of securities. The compulsory acquisition power under s 701 should apply only to the securities of the bid class.

Recommendation 3: Securities of the bid class to which an offeror is entitled at the outset of the bid should be subject to compulsory acquisition under s 701, at the option of the offeror. Any compulsory acquisition notice must be sent to all holders of these securities, except for those held by the offeror or any related corporation.

Recommendation 4: An offeror under a Part A offer or Part C announcement should have the option to compulsorily acquire all later issued securities of the bid class that are issued prior to the first s 701(2) notice, provided that the compulsory acquisition

threshold is satisfied for all issued securities of that class, including those later issued securities.

Recommendation 5: A bidder who is already entitled to 90% or more of a class of securities should be entitled to conduct a Chapter 6 bid and exercise the compulsory acquisition powers under s 701 for that class of securities.

Recommendation 6: Securities of a bid class in which an offeror only has a deemed interest under s 33 should be excluded for the purpose of determining its initial entitlement and whether the compulsory acquisition threshold has been satisfied.

Recommendation 7: The 90% total shares entitlement test in s 701(2)(b) should be retained (though amended to refer to bid class securities) but the 75% in number tests in s 701(2)(c) should be replaced with a test of entitlement to 75%, by value, of outstanding bid class securities.

Recommendation 8: A bidder should be permitted to seek court approval of a compulsory acquisition, notwithstanding that the compulsory acquisition threshold has not been reached. This right should not be confined to instances where the presence of untraceable security holders prevents reaching the threshold. It should be in addition to the right to seek an ASC modification under s 730. The ASC should have the right to require that an application be dealt with by the court.

Recommendation 9: An offeror under an unconditional offer should be entitled to dispatch compulsory acquisition notices (and the requisite time periods for objection commence to run) once the compulsory acquisition threshold has been reached, even where the offer period is still open.

Recommendation 10: Remaining holders of bid class securities who do not proceed with a court application opposing the compulsory acquisition of their securities should be entitled to receive the offer consideration in the period prescribed under s 701(10)(a) or (b) (whichever last occurs), not that under s 701(10)(c).

Recommendation 11: Paragraph 701(6)(b) should be amended to refer to the end of 14 days after the last day on which any dissenting offeree was given a statement under s 701(9).

Recommendation 12: The legislation should make clear that the Gambotto principles do not apply to compulsory acquisitions under s 701.

Recommendation 13: The onus in s 701 should remain on any dissident holder. Fairness should be assessed by reference to the circumstances of the holders as a whole.

Recommendation 14: A court, rather than an administrative body, should conduct any appraisal. Its powers should be limited to either approving or rejecting the compulsory acquisition price for all dissenting applicants. In determining fair value, a court should:

- . assess the value of the company as a whole and determine the value of each class of issued security, taking into account its relative financial risk and its distribution rights
- . expressly disregard whether the remaining securities of the offer class should attract a premium or discount.

If the court decides to reject the compulsory acquisition price as not being for fair value, the compulsory acquisition should fail for all dissidents who have applied to the court.

Recommendation 15: There should be no specific provision in s 701 dealing with cost orders.

Recommendation 16: The legislation should provide that any notice under s 701(2) or (10) is deemed to be given on the day after it is posted by ordinary mail.

Buy-outs: s 703

Recommendation 17: The right of buy-out under s 703 should be limited to remaining securities of the bid class and other securities convertible into the bid class. That right should arise once the compulsory acquisition threshold for the bid class securities has been satisfied.

Recommendation 18: Section 703 should apply to holders of bid class securities issued after commencement of the bid but prior to close of the offer period (unconditional bids) or issue of the s 663(4) notice (conditional bids).

Recommendation 19: Section 703 should not apply to voting shares in a non-bid class unless they are convertible into the bid class.

Recommendation 20: Section 703 should apply to holders of non-renounceable as well as renounceable options convertible into the bid class securities.

Recommendation 21: Persons who are entitled to be registered as holders of securities convertible into the bid class securities at the time of service of the s 703(4) notice should not be entitled to invoke the acquisition rights under s 703(8). This right should remain with the registered holders of those securities.

Recommendation 22: An offeror who proposes buy-out terms for any non-bid securities coming within s 703 should send an independent expert's report with that proposal, regardless of whether the terms are set out in the s 703(4) notice.

Recommendation 23: Subsection 703(1) should be amended to increase the time period for sending a notice from one month to two months.

Share acquisitions under s 414

Recommendation 24: Section 414 should be repealed.

Schemes of arrangement: s 411

Recommendation 25: Section 411 should be amended to place beyond doubt that it applies to compulsory acquisitions of both renounceable and non-renounceable options as well as convertible notes and shares.

Recommendation 26: There should be no alteration to the current requisite majorities in s 411 for a scheme involving a compulsory acquisition of securities.

Recommendation 27: Section 411 should not prohibit any shareholders from voting on a compulsory acquisition scheme of arrangement.

Amalgamations: s 413

Recommendation 28: There should be no amendment to s 413.

Voluntary liquidation and selective distribution in specie: s 501

Recommendation 29: There should be no specific disclosure requirements for voluntary liquidation resolutions where the company's constituent documents permit a selective distribution in specie.

Recommendation 30: The Corporations Law should not prohibit persons who are eligible to receive selective distributions in specie, and their associates, from voting on the voluntary liquidation resolution.

Recommendation 31: Individual shareholders should not have further rights to challenge selective distributions in specie.

Voluntary liquidation - amalgamation: s 507

Recommendation 32: There should be no specific disclosure requirements for any asset transfer resolution under a voluntary liquidation. These matters should be left to the common law.

Recommendation 33: Any transfer of a company's business or property under a voluntary liquidation should require the consent of shareholders by special resolution, with no votes being cast in favour of the resolution by any intended transferee or any associate of the transferee.

Sale of assets and liquidation

Recommendation 34: The restrictions on sale of assets in the ASX Listing Rules should not be included in the Corporations Law.

Appendix 3

Reform of s 414 (if retained)

1. The Legal Committee has recommended that s 414 should be repealed.¹⁹⁷ In this Appendix, the Legal Committee sets out various recommendations for reform of s 414 if, contrary to the Committee's recommendation, the section is retained.

Outline of procedure

2 A scheme or contract involving a transfer of shares must be approved by the holders of at least 90%, in nominal value, of the relevant class, excluding the offeror's shares or those of its nominee or subsidiary (the outstanding shares test).¹⁹⁸ Also, where the offeror, or its nominee or subsidiary, initially holds more than one-tenth of the aggregate nominal value of the issued shares in the relevant class, acceptances must be received from not less than three quarters in number of the holders of shares in the class, again excluding the offeror, its nominees and subsidiaries.¹⁹⁹

Notice

3 A s 414 scheme or contract requires neither court approval nor a meeting of shareholders. It is only necessary that it be approved by the requisite number of shareholders. Also, unlike s 411 or s 701 schemes, there are no statutory disclosure requirements for s 414 offers. However, various controls apply. For instance, s 995 and s 999 prohibit misleading or deceptive conduct or statements in connection with the offers.

Issue: Should companies be obliged to give the ASC notice of their intention to enter into a s 414 scheme?

¹⁹⁷ Recommendation 24, *supra*.

¹⁹⁸ s 414(2).

¹⁹⁹ s 414(5). Joint holders are counted as one person: s 414(6).

Submissions

4 The submissions were divided on whether companies should be obliged to give notice to the ASC of their intention to enter into a s 414 scheme.

5 The ASC and the SIA supported this obligation. The notice should specify whether or not the proposed s 414 scheme will have a substantial effect on the application of Chapter 6 to the company's shares.

6 One submission argued that given the high percentage required for approval of a s 414 scheme, it is not necessary for the ASC to be given notice of intention.²⁰⁰ Another submission argued against any obligation to give notice unless the ASC was to be given some particular monitoring role in relation to such a scheme.²⁰¹

7 The Law Council also opposed any obligation to give notice prior to entering into a s 414 scheme. However, a company should be obliged to give the ASC notice before giving notice to dissenting shareholders and the ASC should have a right to apply to the court under s 414.

Legal Committee response

8 The Legal Committee does not see what purpose would be served by requiring a company to give the ASC notice of its intention to enter into a s 414 scheme. Rather, the company should give the ASC notice when giving notice to dissidents.²⁰² Also, the ASC should have a right to apply to the court under s 414 to challenge the compulsory acquisition of shares held by dissidents.

200 Corrs *Submission*.

201 Rosenblum *Submission*.

202 para 23, post.

Recommendation I: A company undertaking a s 414 scheme should be obliged to give the ASC notice when giving notice to dissidents. Also, the ASC should have a right to apply to the court under s 414 to challenge the compulsory acquisition of shares held by dissidents.

Issue: Should s 414 contain specific minimum disclosure requirements for shareholders?

Submissions

9 Submissions were divided on whether s 414 should contain specific minimum disclosure requirements for shareholders.

10 The ASC argued that it was important to ensure that shareholders receive such information as is necessary to enable them to form a judgment on the merits of the proposal. In order to achieve consistency between the various provisions which permit compulsory acquisition, s 414 should require a level of disclosure similar to that which is required before s 701 can be used. Another submission took a similar position.²⁰³

11 The SIA also supported minimum disclosure requirements, observing that the information disclosed should include an independent expert's report unless, say, 90% agree otherwise.

12 One respondent argued that guidelines already set by the courts do not need to be embodied in legislation.²⁰⁴

13 The Law Council submitted that case law makes it clear that approval obtained without full disclosure will not be valid. More detailed guidelines do not need to be embodied in

²⁰³ Rosenblum *Submission*.

²⁰⁴ Corrs *Submission*.

legislation. Instead, the Law Council proposed general disclosure principles.²⁰⁵

Legal Committee response

14 The Legal Committee considers that the necessary information for minority shareholders is already contained in the s 414 offer documents.

Recommendation II: There should be no amendment to s 414 to introduce specific disclosure requirements for shareholders.

Threshold for approval of scheme

15 A s 414 scheme must be approved by the holders of at least 90%, by value, of the relevant class of shares, other than "excluded shares".²⁰⁶ Also, under s 414(5), where the nominal value of "excluded shares" exceeds 10%, by value, of all the relevant shares, the scheme must be approved by at least 90%, by value, of the shares (other than the excluded shares) to be transferred under the scheme which are also at least three quarters in number of the holders of those shares.

16 The ASC submission to the Lavarch Committee expressed concern about the ease of circumventing the numerical requirements in s 414(5). It argued that the definition of "excluded shares" in s 414(1) is so antiquated that it can be

²⁰⁵ The Law Council proposed that s 414 should require:

- (a) disclosure to the minority holders of all information that they and their professional advisers could reasonably require to evaluate whether the consideration is fair; and
- (b) either:
 - (i) an independent expert's report establishing that the consideration is fair; or
 - (ii) prior acceptances for the consideration, from shareholders not associated with the acquirer and in respect of shares to which the acquirer was not previously entitled, comprising over 75% of the outstanding shares, excluding uncontactable shareholders.

²⁰⁶ s 414(1).

avoided by an intending offeror who holds at least 90% of the shares, transferring them to a "related company" that is not a nominee or direct subsidiary. The transferee company can then, by accepting the offer, grant the necessary 90% approval even though it is owned by the same holding company as the offeror. This arrangement also circumvents the 75% in number requirement as the offeror then holds less than 10% of the excluded shares. This has enabled a number of offerors who were unable to satisfy the tests in s 701(2) to resort to s 414 to eliminate minority shareholdings.²⁰⁷ The ASC argued that the definition of "excluded shares" in s 414 should be replaced with a reference to "shares to which the offeror is entitled" within the meaning of s 609, thereby attracting the broad definitions of "relevant interest" and "associate" in the legislation. This would capture artificial devices and avoid having to prove that the related non-subsiary was the nominee of the offeror.

17 The Lavarch Committee recommended that the right of compulsory acquisition in s 414 not be available unless the thresholds and their calculations are determined in the same manner as under s 701.²⁰⁸

18 The Legal Committee noted in the Issues Paper that s 414(5) currently employs the more onerous 90% of outstanding

²⁰⁷ ASC Submission to the Lavarch Committee at 119. Digby, *supra*, note 4 of Report at 111-12 refers to a similar device under s 414, the legality of which is doubtful, to overcome the 75% in number requirement where, following a formal takeover scheme, a bidder is entitled to more than 90% of the issued voting shares of the target but cannot satisfy the 75% in number test. The device involves the bidder incorporating a special purpose subsidiary, which, being an "associate" of the bidder, is already "entitled" for the purposes of Chapter 6 to the bidder's shares in the target. Accordingly, the subsidiary is able to acquire further shares in the target company without contravening s 615. However, given the limited definition of excluded shares in s 414(1), the subsidiary will not itself hold any shares in the target company and will not be required to satisfy the 75% in number requirement in s 414(5). It can thus make offers to acquire all the shares in the target company, assured of gaining approval from its parent company to satisfy the 90% approval requirement in s 414.

²⁰⁸ Lavarch Committee Report: *Corporate Practices and the Rights of Shareholders* (1991) Recommendation 10.

shares test, rather than the 90% of total shares test, as found in s 701.²⁰⁹ To adopt the ASC submission to the Lavarch Committee, without amendment, could result in s 414 being significantly more difficult to satisfy than s 701.

Issues:

- . **Should the relevant test for the 90% threshold in s 414 be changed from the outstanding shares test to a total shares test?**
- . **Should the 75% in number requirement in s 414 be abolished?**

Submissions

19 The submissions generally supported the principle that the threshold test in s 414 should be consistent with that in s 701. The ASC, however, supported an outstanding shares test in both instances.

20 All submissions supported abolition of the 75% in number requirement.

Legal Committee response

21 The Legal Committee supports the compulsory acquisition threshold in s 414 being the same as under s 701. It has elsewhere recommended a new 90% total/75% outstanding shares test for determining that threshold in s 701.²¹⁰ The same test should apply to s 414.²¹¹

²⁰⁹ Paragraph 414(5)(b), inter alia, requires approval of the scheme or contract by nine-tenths in nominal value of the shares to be transferred, other than the excluded shares.

²¹⁰ Recommendation 7.

²¹¹ Given this, Issue 34 of the Issues Paper is no longer relevant. The s 701 compulsory acquisition threshold is based on entitlement. It does not use the concept of "excluded shares".

Recommendation III: The 90% total/75% outstanding shares compulsory acquisition threshold proposed for s 701 should also apply to s 414.

Issue: Should the ASC be given a discretionary power to relieve an applicant from compliance with the relevant percentage test(s) in s 414?

Submissions

22 The majority of the submissions supported the ASC having this power, in the interest of promoting flexibility.

Recommendation IV: The ASC should be given a discretionary power to relieve an applicant from compliance with the compulsory acquisition threshold in s 414.

Rights of dissidents

23 Upon obtaining the necessary acceptances, the offeror may give notice of compulsory acquisition to any non-accepting shareholders. That notice both entitles and binds the offeror to acquire the dissenting shareholders' shares on the terms approved by the requisite 90% majority unless the court orders otherwise on application by a dissenting shareholder.²¹² As with s 701, the court may exempt an applicant's shares from compulsory acquisition. There is some doubt whether, alternatively, the court can impose different expropriation terms (appraisal rights).²¹³

²¹² s 414(2), (3).

²¹³ Contrast the limited powers of s 414(3), under which a compulsory acquisition on the terms approved by the 90% majority shall go ahead "unless the court orders otherwise", with the specific judicial appraisal powers in s 414(10)(b), which provides that a transferee may be bound to acquire shares "on such other terms as the Court thinks fit to order". The latter provision covers the circumstances where a transferee under a scheme or contract becomes beneficially entitled to 90% of the shares of a class, but elects not to issue a compulsory acquisition notice under s 414(2). In that case, a minority shareholder may give notice requiring that the transferee acquire the shares: s 414(9) (cf s 703(1)-

Issue: Should specific provision be made for appraisal rights for dissident shareholders in s 414 schemes. If so, what form should they take, and what, if any, provision for cost orders should be made?

Submissions

24 Submissions, generally, did not support specific appraisal rights provisions being included in the legislation.

25 The ASC said that appraisal rights in relation to bids are problematic and should not be enacted. The AICD also rejected dissident shareholders having appraisal rights over and above existing oppression remedies. Another argument against appraisal rights was that the transferee should be entitled to know the terms on which it is electing to become bound to acquire shares.²¹⁴ The SIA did not support a specific appraisal rights provision. If the terms are approved by the requisite majority but not by the court, other expropriation terms should not be imposed on the offeror. Also, costs orders should be at the discretion of the court.

26 One respondent submitted that s 414(3) should be amended to make clear that the court's powers on application by a dissenting shareholder relate only to the acquisition of shares held by that dissenting shareholder, not by other remaining shareholders.²¹⁵

Legal Committee response

27 The Legal Committee considers that it is inappropriate for a court to determine a specific buy-out price in cases of dispute.²¹⁶ Rather, in the context of s 414, the court's powers

(3)). Renard & Santamaria, *supra*, note 4 of Report at [1217] refer to case law both supporting and opposing the proposition that the court has power to alter the consideration payable under the offer. In any event, it is clear that the court can award interest in appropriate circumstances.

²¹⁴ Rosenblum *Submission*.

²¹⁵ Rosenblum *Submission*.

²¹⁶ cf paras 2.88 and 10.37, *supra*.

should be limited to approving or rejecting expropriation terms, and only for those dissidents who have applied to the court.

Recommendation V: The court's powers under s 414 should be limited to approving or rejecting expropriation terms, and only for those dissidents who have applied to the court.

Other matter

28 One respondent pointed to a timing conflict under s 414. Subsection 414(9) requires an offeror to give notice to remaining shareholders within 1 month of reaching the 90% threshold. However, s 414(2) allows 2 months for the compulsory acquisition notice to be given.²¹⁷

Recommendation VI: The time frame in ss 414(2) and 414(9) should be consistent, being two months.

²¹⁷ Freehill *Submission*.