COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

REPORT TO THE MINISTERIAL COUNCIL ON PARTIAL TAKEOVER BIDS

AUGUST, 1985.

REPORT OF THE COMPANIES AND

SECURITIES LAW REVIEW COMMITTEE

on

PARTIAL TAKEOVER BIDS

[1] The Committee has received a general reference from the Ministerial Council to enquire into and review the question of the appropriateness of the Companies (Acquisition of Shares) Act 1980, (CASA) as a mechanism for regulating takeovers in Australia.

[2] Although these terms of reference would justify consideration of whether the scheme of regulation of takeovers provided by CASA should be departed from, the Committee, at this stage, considers:

(1) that some legislative control of takeovers is needed in the interest of shareholders; and

(2) that, in these circumstances, there should be no fundamental departure from the general framework established by CASA since that Act is now generally understood in the business community and is working satisfactorily except in some specific areas.

[3] It is within this context that the Committee has examined the matter of partial bids. The Committee decided upon this review as partial bids provide a focus for some general policy issues in the context of this area of concern with the operation of the present legislation.

[4] A discussion paper on partial bids was prepared and issued in March 1985. This paper is reproduced in Appendix 1. Some 500 copies were circulated and submissions called for by May 1985. A list of respondents is found in Appendix 2.

[5] The Committee now reports its views and recommendations. A summary of the recommendations is found in Appendix 3.

Structure of the Report

[6] The report is designed to summarize and comment on submissions made in response to six propositions posed by the Committee in the Discussion Paper (Para 52). The report is structured around these propositions and also discusses other options. The report does not outline or analyse in detail the present law dealing with partial bids as this is dealt with in the attached Discussion Paper.

Perspective of the Report

[7] The Committee reiterates the view expressed in the Discussion Paper that partial bids perform a legitimate economic function and, while presenting shareholders with some difficulties, may also be beneficial to investors. The Committee is conscious of the significant public interest in the regulation of partial bids and believes that they should not be subjected to substantial restrictions beyond those needed to secure reasonably equal opportunities for offeree shareholders to consider the bid and participate in its benefits without coercion.

[8] The Committee has accordingly adopted the principle that reform proposals should be evaluated according to whether they:

* directly and effectively respond to perceived short-comings in the existing regulation of partial bids; and

* do not unreasonably deter partial bids.

[9] Proposition 1: that there be included in the legislation a clear statement of the basic objectives that it seeks to achieve, being the principles stated in section 59 and 60 of CASA, amplified by a further principle that as far as reasonably practicable the value of any premium for control should be at all times proportionately vested in each voting share.

[10] The Committee is aware of the lack of consensus in the commercial community on the meaning, application and utility of the control premium concept. Furthermore, differing views have been expressed as to whether it is appropriate to enshrine as one of the basic objectives of CASA a matter which may impinge on the value and pricing of shares. The Committee is also conscious of the need to focus directly on the potential coercive effects of partial bids and this task could be obscured by continued debate on the control premium concept. Accordingly, the Committee believes that it would be inappropriate to recommend that the legislation include a philosophical statement concerning the rights of shareholders in relation to the control premium.

[11] Proposition 2: that a partial bid be capable of being made only for a specified proportion of each shareholding.

[12] The proposal to confine partial bids to proportional bids was designed to reduce significantly the coercive pressures on shareholders that may exist under pro-rata bids. Acceptances may flow under pro-rata bids not from a belief that the offer is fair, but from a fear that failure to accept is a worse alternative. These coercive elements and other problems associated with pro-rata bids are summarised in the Discussion Paper Para 11-13; 23-26; 46-47.

[13] Proportional bids will ameliorate the coercive effects of pro-rata bids in the following ways:

* They may eliminate the pressures to sell in an attempt to maximise the number of shares sold.

[14] The fewer the shareholders who accept under a pro-rata bid, the more likely it is that disproportionate benefits will flow to those who do. By contrast, in a proportional bid, failure to tender does not inevitably imply a corresponding increment in the number of shares sold to the bidder by accepting shareholders. Proportional bids overcome the incentive to accept the offer not on its merits but in the anticipation of selling a disproportionate number of shares and obtaining a disproportionate share of any premium attached to the bid.

* They may remove uncertainty as to the number of shares each shareholder can sell to the offeror.

[15] Under proportional bids, accepting shareholders would know the precise proportion of their shares the bidder might acquire from them and thus would be free to enter into commitments with respect to their residual shares. This overcomes the problem with pro-rata offers that accepting shareholders cannot know how many shares the bidder will acquire until the offer closes and acceptances are pro-rated.

[16] Restriction of partial bids to proportional bids is not intended to eliminate all uncertainties for the offeree shareholders. The possibility remains that the bid may fail outright through non- fulfillment of particular bid conditions. These uncertainties are borne by all persons who accept conditional bids and are not peculiar to proportional bids.

[17] A number of submissions were critical of the proposal to confine partial bids to proportional bids. The substance of these criticisms and the Committee's response to them are summarised:

* Confining partial bids to proportional bids would unreasonably discourage or virtually eliminate partial bids.

[18] The Committee recognises that the proportional bid route is not 'costless' for the bidder and to that extent does increase his risks. The history of partial bids in Australia indicates clearly that given the choice, bidders invariably prefer pro-rata to proportional partial bids. However, to establish merely that the proportional bid route raises the costs and risks to which bidders are subject falls well short of determining that a limitation to proportional bids will fundamentally discourage partial bids. The Committee believes that this 'doomsday' prediction is an over-reaction and ignores the capacity for bidders to respond to the changed circumstances of partial bids and attach minimum acceptance and other conditions to protect their position.

* Offerors would have no confidence that they would reach their target level of control.

[19] No bidder, in either a proportional or full bid can be fully confident that the bid will succeed. Such uncertainty is of the very nature of takeover bids. Whether bidders reach their target levels will depend in the final resort upon the attractiveness of the bid.

* Proportional bids make it more difficult for an offeror to achieve a level of acceptances that would satisfy any minimum acceptance conditions.

[20] Proportional bids do place a greater onus on the offeror to calculate the terms of the bid, and this will involve a degree of estimation. It is also true that compared with pro-rata bids, higher levels of shareholder acceptances are required for proportional bidders to achieve their minimum desired shareholding in target companies. To this extent proportional bids do transfer risks from offeree

shareholders to offerors and increase the likelihood of such bids failing, particularly if they are hedged with fairly stringent minimum acceptance conditions. The Committee believes, however, that over time offerors will adjust to this situation and that the overall benefits arising from proportional bids will outweigh any detriment that may arise from failure of particular proportional bids. The Committee does not share the view that proportional bids will so increase the costs and risks associated with partial bids that they will become virtually extinct.

* Proportional bids will result in all shareholders (rather than those who did not accept under a pro-rating system) being locked into a minority position following any change in control

[21] It is of the very nature of partial bids that minorities may arise. As identified in the Discussion Paper, fear of becoming a locked in minority is one of the principal mechanisms which generates the coercive forces for acceptance of pro-rata bids. Proportional bids would lessen these forces by eliminating any expectation on the part of accepting shareholders that they may receive, in effect, the benefits of a full bid or a disproportionate share of any bid premium. Proportional bids would force shareholders to consider the merits of the bid on its true terms, namely, as one for less than all the shares in the target company, with the real possibility that shareholders may become locked-in minorities.

* Proportional bids do not address the problem of coercion which arises where shareholders believe that the offer is inadequate, but sell to the bidder through fear that other shareholders will accept.

[22] The function of proportional bids is to create certainty for shareholders regarding the number of shares which can be tendered to the bidder. It overcomes the temptation with pro-rata bids to tender not on the merits

of the bid but in the hope of selling all or a disproportionate number of one's shares and avoid being a locked-in minority. To this extent the proportional bid proposal addresses coercion.

[23] It is not the function of proportional bids to overcome all the coercive elements arising from partial bids. These are further dealt with under the shareholder plebiscite proposals; see [85]-[88].

* Proportional bids may encourage bidders to engage in 'small bite, front-end loaded' bids.

[24] Experience of takeovers in overseas jurisdictions, particularly the USA, indicates that bidders may engage in what is known as 'coercive front-end loaded' bids whereby they make a partial bid at a high premium for minimum effective control of a company and simultaneously indicate their intention to mount a subsequent follow-up bid for the remaining shares at a much reduced price. This puts pressure on shareholders to accept the initial bid in order to maximise their returns.

[25] The Committee believes that the potential to engage in this possibly coercive arrangement is as much present in pro-rata bids as proportional bids and to that extent cannot be taken as a criticism of proportional bids. The potentially coercive effects of front-end loaded bids are further addressed in the discussion on shareholder plebiscite provisions; see [85]-[88].

* Proportional bids may create a minority veto power over the bid's success.

[26] The instance given is where a bidder, holding no shares in the target, makes a bid for 50% of the target, with a 50% minimum acceptance condition. It is further assumed that 30% of the shareholders are opposed to the bid and

decide not to tender. As a result the bidder can acquire only 50% of the shares that are tendered (here 70%)and so would finish up with, at most, a 35% minority interest in the target. It is therefore argued that the 30% opposition minority has effectively vetoed the takeover offer.

[27] The Committee believes that the above example does not establish the proposition that proportional bids may create a minority veto. The bidder, may, for instance, acquire 20% in the pre bid period and/or increase the proportion of each shareholding bid for e.g. 80% in the above example. A minority veto result would arise only where a bidder significantly underestimated the proportional offer. Even so, it is within the bidder's discretion to make a further bid for an increased proportion of each shareholding.

[28] In summary, the Committee considers that none of the criticisms raised has sufficient weight to undermine or counterbalance the benefits accruing from confining partial bids to proportional bids.

[29] The Committee has given consideration to whether it would be appropriate to allow proportional bidders to impose maximum as well as minimum acceptance conditions. The function of maximum acceptance conditions would be to protect a bidder from having to take up more shares than desired, which may otherwise arise where there is a higher acceptance rate than anticipated. For instance a bidder starting at 0% entitlement and seeking to obtain 51% of the total shareholding might make a proportional bid for 75% of each shareholding, conditional upon a minimum acceptance of 51% and a maximum acceptance of (say) 60% of the total shares. In this context, the maximum acceptance condition would allow the bidder to exercise a further control over his obligations to take up shares pursuant to the bid.

[30] The Committee has formed the view that it would not be desirable to permit bidders to include maximum acceptance conditions in proportional bids. The Committee raises both practical and philosophical objections to their use.

[31] At a practical level maximum acceptance conditions may not be workable within the current format of CASA. For instance, assume that some seven days before the end of the offer period the bidder, in the above example, has received acceptances which in total constitute 55% of the target company's shares. Taking into account that this is the final opportunity to lift the condition (CASA s28(2)), the bidder in then in a dilemma.

[32] If the bidder declares the offer free from the maximum acceptance condition at that point, there may be a flood of acceptances taking his holding to 70% or more, which is exactly what the bidder does not want. On the other hand, if the bidder decides, seven days before the end of the bid period, to allow the maximum acceptance condition of 60% to stand and acceptances in the last seven days take his overall level even marginally above that figure, the condition is not satisfied and the bid fails altogether. This also would appear to be an unsatisfactory result. This problem will remain even if the proposed amendment to CASA s28 set out in the Exposure Draft Companies & Securities Legislation (Miscellaneous Amendments) Bill, 1985, is enacted as the proposed s28 will prohibit offerors declaring the bid free from conditions within the last five business days of the bid period.

[33] The problems arising from the interaction of maximum acceptance conditions and CASA might, in theory, be dealt with in various ways, for example:

* Exempting proportional bids from the operation of CASA s28;

* Amending CASA to allow the bidder to decide whether to enforce or waive the condition at any time, within, say, seven days after the close of the bid;

* Treating the condition as a form of stipulation either that the offeror cannot or is not obliged to take up more than the stated maximum of the total shares. Under this maximum acquisition obligation option, excess acceptances would be pro-rated down until acceptances totaled the maximum stipulated figure.

This option would maintain the structure of proportional bids to the extent that offeree shareholders would know the minimum proportion of their shareholding which could not be disposed of to the bidder, while allowing for a limited degree of pro-ration.

[34] The Committee does not favour any of these options as they would introduce significant differences between the way conditions are viewed and treated under full and partial bids. More fundamentally, maximum acceptance conditions or maximum acquisition obligations may re-introduce unacceptable uncertainties for offeree shareholders, thereby transferring the risks too far back in their direction. The Committee is also concerned that bidders may utilize maximum acceptance conditions to avoid honouring bids that prove to be more generous than required. For these reasons the Committee believes that maximum acceptance conditions should be prohibited.

[35] It is necessary to deal with the possibility that, in the course of a proportional bid, some accepting shareholders may transfer the residue of their shares. As matters now stand under CASA s25, the transferee may be entitled to accept the bid in respect of the stated proportion of those residual shares. The effect would be that a higher proportion of certain original blocks of shares may be eligible for acceptance under the bid. In response to this a number of options are available:

* Ensure that each original block of shares can be offered once only pursuant to the bid.

[36] This might be achieved by amendment to CASA Section 25 to provide that in respect of a proportional bid, the offer is confined to those persons registered as members of the target company on the date of the offer. Assignees would be prohibited from accepting pursuant to the bid.

* Give the bidder a discretion as to whether the offer is open to assignees or not.

[37] A precedent is found in Section 180K of the Companies Act, 1961 (as amended in 1971) under which the takeover offer was deemed to have been made to an assignee 'except in so far as the offer otherwise provides'. The bidder could, if he wished, confine the offer at the outset to persons on the register at a particular date, or alternatively apply the offer to assignees. The Committee favours adoption of this principle for proportional bids and therefore recommends amendment of CASA Section 25 to provide offerors with this discretion.

[38] RECOMMENDATION 1

The Committee recommends that:

*** Partial bids be confined to proportional bids;**

*** Bidders be prohibited from including maximum acceptance conditions in such bids;**

*** Bidders be entitled, at their discretion, to confine the offer to persons registered as members of the offeree company at the offer date.**

Nominee Shareholders

[39] One submission referred to a particular problem that may arise under partial bids. It concerns the legal position of a nominee who receives a takeover offer for a specified proportion of its holding.

[40] It was argued that under current interpretation a proportional offer is capable of being accepted only in relation to the whole of the nominee's holdings. This may result in the nominee being unable to protect the differing interests and wishes of the underlying beneficial owners.

[41] The Committee believes that nominees should be entitled to have regard to their various beneficial holdings and accept in respect of each holding, separately, if they so wish. It is, therefore, important to ensure that proportional offers made to a nominee should be deemed to be made to each underlying holder within that nominee.

[42] The same principle should apply where a trustee holds shares on the terms of several trusts. It may be necessary for the trustee to determine whether the offer should be accepted, having regard to the interests of the beneficiaries under the various trusts. There may be situations in which the interests of beneficiaries under one trust call for acceptance while the interests of beneficiaries under another trust require rejection.

[43] The Committee notes that this problem is not confined to partial bids. A nominee or trustee may face the same difficulty with a full bid and should have the same flexibility as with a partial bid. For this reason the following recommendation is cast in general terms.

[44] RECOMMENDATION 2

That CASA be amended to provide that:

(a) Where an offer is made to a shareholder who, in his acceptance, states that he is a trustee or nominee who holds a single parcel of shares in such a way that distinct parts of the whole are held for the account or benefit of different persons, that offer shall be deemed to constitute a separate offer in respect of each part and to be capable of acceptance by that shareholder accordingly; and

(b) It shall be an offence for a shareholder to make in an acceptance a statement of the kind mentioned in paragraph (a) which is false.

Mandatory Extension of the Bid Period: A Proposed Alternative to Proportional Bids

[45] A joint submission by Capel Court Corporation Limited and Blake and Riggall expressed the view that many of the problems associated with partial bids arise because in many cases control passes very late in the offer period. They argued that:

* Some accepting shareholders wait until the latest possible time before accepting a partial bid.

* Other shareholders assume that an initial low response to a takeover bid indicates that the bid will not succeed and therefore do not accept.

* It is generally apparent only in the last few days or hours of a partial bid that control has passed or that the bid may succeed.

[46] As a result, the submission states, there is generally insufficient time for a target board to reconsider a recommendation to reject a partial bid and advise shareholders accordingly. Many shareholders therefore become aware that control has passed only when it is too late for them to accept the offer.

[47] The result is that at a time when, in practical terms, a final decision to accept the offer must be made, many shareholders are unaware of, or unable to determine, whether control has, or will, pass.

[48] To overcome these perceived timing problems, Capel Court and Blake and Riggall have put forward two alternative proposals within the context of maintaining pro-rata partial bids.

Alternative 1

[49] The legislation be changed to require every partial bid to be automatically extended for 10 business days from the close of the primary offer period if, during the primary offer period, the offeror already has become entitled to 20% of the shares in respect of which offers were made, (or alternatively, of the shares to which the offeror was not entitled at the date of the offer), or to 50% of all the voting shares in the target. All acceptances, whether during the primary offer period or the 10 day extension, would be capable of increasing the entitlement of the offeror up to the target level of entitlement stated in the formal offer.

[50] The submission pointed to a fundamental shortcoming with this proposal, namely that if a partial bid was launched from a low shareholding level, the 10 day extension period may apply in circumstances where it would be of little benefit as at the end of the primary offer period, the directors and shareholders of the target would be in no better position to assess the likelihood of the partial bid being successful and control passing.

[51] The Committee agrees with this criticism and does not support Alternative 1.

Alternative 2

[52] The legislation be changed to require every partial bid to be automatically extended for 10 business days after the close of the primary offer period if, at that time, the offeror is entitled to more than 20% of the voting shares in the target company. There would be a further requirement, that if, at the close of the primary offer period, the offeror is entitled to less than 50% of the voting shares in the target company, then acceptances received during the 10 day extension period should, together with acceptances received prior thereto, be pro-rated so that the final entitlement of the offeror is the same as its entitlement at

the close of the primary offer period. In these circumstances, the number of shares which the offeror may acquire pursuant to the bid is determined by reference to the primary offer period (the closing entitlement) and shareholders are given an extended period to determine whether they should participate in the offer.

[53] The Committee has given close consideration to this proposal which, on its face, appears to be a clear alternative to the Committee's recommendation to confine partial bids to proportional bids. This mandatory extension proposal also appears, at a theoretical level, to meet many of the reform objectives set out in the Discussion Paper in that:

* It removes the competitive and coercive aspects of partial bids that arise as a result of the timing factors referred to, since an offeree shareholder would no longer risk missing out on a share of any bid premium by not accepting the bid in the primary offer period. The proposal represents a response to the perceived problem that shareholders who believe that the offer is inadequate have no opportunity to accept the offer if it is successful.

* It satisfies the principle that all shareholders be provided with full information and an equal opportunity to participate in the bid.

[54] As the submission points out, target boards could be confident that advice not to accept a less than adequate partial bid would not disadvantage those shareholders following this advice since, if it subsequently becomes clear that control has passed or was likely to pass or that there had been a significant level of acceptances, there would be sufficient time for directors to recommend acceptance, to advise shareholders accordingly and for those shareholders to decide whether to accept the offer. Shareholders could be confident that if they decided not to accept a partial bid in

the primary offer period, but the offeror achieved control, the ten day rule would provide them with sufficient time to accept the offer and thereby participate in any control premium being paid by the offeror.

[55] In this respect the proposal appears to overcome the problems of uncertainty and lack of information that may otherwise arise at a time when the decision to accept or reject a partial bid must be taken.

[56] Notwithstanding the theoretical virtues of this proposal, the Committee believes that it is not workable. It recognises but fails to take fully into account, the reasons why some investors tend to delay accepting a partial bid, namely:

* to see whether a competitive full or partial bid will emerge;

* to ascertain whether a better price for their shares may be obtained in the stock market or pursuant to a private transaction;

* to determine the likelihood of their shares being pro-rated should they accept the bid (some shareholders would be more inclined to accept a partial bid if it appears minimal or no pro-ration will take place).

[57] On this basis shareholders seeking to maximise their potential return may prefer to delay accepting a partial bid until near the end of the mandatory extension period. It is unlikely to be in the interests of these shareholders to accept an offer prior to the close of the primary offer period. To do so would be to deny themselves the opportunity of accepting a higher counter bid should it emerge, or to sell all or some of their holdings to another party at

a higher price. Shareholders would often be unable to determine the likelihood or degree of pro-ration until near the end of the extension period and this would be a further disincentive to accept the bid in the primary offer period. Only those shareholders who strongly favoured the bid's success or wished to sell in any event would be highly motivated to accept in the initial period.

[58] The result could be to depress the level of acceptances of many partial bids at the end of the primary offer period. This would increase the likelihood of these partial bids failing to satisfy any minimum acceptance conditions. The proposal may be too disadvantageous for bidders and would unduly increase the likelihood of bids failing, particularly if there were minimum acceptance conditions.

[59] The Committee therefore believes that the proposal to include a mandatory extension period for partial bids cannot be supported.

[60] Proposition 3: A partial bid not be permitted in the case where a person who is already entitled to 10% of the Company's voting shares would increase his entitlement to more than 20% as a result of the bid.

[61] This proposition was designed to address problems arising from the acquisition by the bidder of strategic holdings in the target company prior to the launch of the partial bid.

[62] Reduction of the threshold might have the following benefits:

* It may enhance equality of opportunity by lessening the number of shareholders who could obtain undue advantage by selling all their shares to the bidder (possibly at a premium or with an escalation clause) prior to launch of the bid.

* It may increase the proportion of each remaining shareholding that would have to be acquired in a proportional bid, and thereby benefit those shareholders.

* It would seek to meet the criticism of partial bids that the margin between the 20% threshold and the percentage ownership needed for practical control may be so small as to favour the bidder unduly.

* It may facilitate the emergence of competitive bids as the 10% threshold is less of an inhibition to a potential counter bidder than the present 20% threshold.

[63] The Committee however, is conscious of strong arguments against reduction of the threshold:

* A reduction would increase the costs and risks of takeovers to partial bidders and, to this extent would discourage such bids.

* A reduction may make it more difficult for some parties to mount partial bids, thereby lessening rather than strengthening the competitive elements in takeover bids. The instance most commonly referred to is of a shareholder who currently holds greater than 10% of the shares at the time the bid is launched. In order to make a counter partial bid, this shareholder would have to reduce his holding to 10% or seek administrative exemption; if this was not possible, the shareholder would have no option other than a full counter bid.

* A 10% threshold may put a partial bidder at a severe competitive disadvantage relative to a person making a full bid from close to the 20% threshold.

[64] The Committee believes that, on balance, it would be referable not to reduce the threshold for partial bids. The takeover legislation creates a two tier market and there do not appear to be any compelling considerations in favour of altering this system for partial bids. It seems preferable to maintain the principle of a free market up to the 20% threshold. Introduction of a double threshold for takeovers would add unnecessary complexity to this framework.

[65] The Committee believes that rather than reduce the threshold, it may be more appropriate to concentrate on specific problems associated with pre-bid acquisitions.

Pre Bid Acquisitions

[66] Under current rules, intending partial bidders may, depending upon their existing share entitlement, acquire up to 20% of the target company's shares free of the legislative constraints that arise once the bid is launched. Share-holders who sell to the intending bidder in the pre bid period may receive benefits not available to those shareholders who accept under the subsequent offer, such as an unconditional and immediate sale of all their shares at a price which may be at a premium to that which is subsequently offered under the bid, or which is otherwise protected by escalation clauses. This may place pressure on shareholders to sell to the intending bidder in the expectation of a higher return; it appears to support, if not encourage, differential treatment of shareholders by the bidder and this generates the criticism that intending partial bidders can effectively force or stampede acceptances in the pre bid period.

[67] The Committee believes that any thorough revision of partial bids must recognise the inter-relationship between the pre bid 'free market' and the bid itself, and how this may impinge on shareholder behaviour. The Committee does not favour the extreme step of eliminating pre bid acquisitions, but considers that some controls should be introduced to lessen the potentially coercive and discriminatory features of such acquisitions by the bidder. A number of reform options are available:

* The London City Code approach.
* Reduction of the disclosure threshold.
* Regulation of escalation clauses.
* Introduction of price equity.

The London City Code Approach

[68] The Committee considered whether to adopt the principle found in the London City Code Rule 36.2, which prohibits an offeror or its associates from making a partial bid where any of those persons has acquired a significant number of shares in the offeree company during the 12 months preceding the proposed bid date. This rule is designed to prevent offerors making 'raids' just prior to launching a partial offer.

[69] The Committee believes that while such a rule may overcome a number of problems associated with the existence of a free market to 20% and encourage equality of opportunity amongst shareholders, it could do so in a manner that is too heavy-handed. Any timeframe and percentage entitlement set down in the legislation would be arbitrary and could have inequitable effects in particular situations. The proposal

could limit significantly the number of partial bids and inhibit counter bids in much the same way as would the reduction of the threshold. The Committee envisages that many bidders would seek administrative exemption from this rule and this of itself would call into question its appropriateness and utility. The Committee does not favour introduction of a provision that would attract to itself a high incidence of applications for its non-observance.

Reduction of the Disclosure Threshold

[70] Another submission was to reduce the substantial shareholding threshold from 10% to 5%, and extend the sanctions for nondisclosure to a prohibition on any persons who had not complied with the disclosure requirements from undertaking partial or full bids. It was argued that these measures would give shareholders a better opportunity to make a more timely and informed decision about their share investment in the knowledge that a person had acquired a substantial shareholding in the company.

[71] The Committee believes that any reconsideration of the substantial shareholding disclosure threshold (a matter already referred to in passing in the Committee's Report to the Ministerial Council on the Takeover Threshold) raises issues which are not confined to partial bids and are outside the ambit of this review. Accordingly, the Committee has not further considered this question.

Escalation Clauses

[72] Where shareholders sell to the bidder under escalation clause contracts in the pre bid period, they obtain the twin benefits of selling all their shares while participating in any premium to be given under the bid in respect of a proportion of all other shares. Escalation clauses make for a relatively risk free decision by

shareholders who are approached by the bidder, as they have the comfort of knowing that they will eventually obtain a price equal to the highest under the bid. These shareholders are considerably advantaged vis a vis other shareholders of the target company. Escalation clauses may also allow a potential bidder to obtain a significant foothold at prices lower than that which might otherwise have to be paid and thereby enable the bidder to make a formal bid at a lower price than otherwise.

[73] The Committee is conscious of the inequitable effects between shareholders of escalation clauses, but does not believe that it is appropriate here to recommend their prohibition. Rather there is a need to inhibit their use in the context of partial bids. The Committee therefore favours enactment of a provision prohibiting a bidder from making a partial bid if this could result in that bidder or any associate incurring any obligation to make a payment under any pre-existing escalation agreement. Such a provision would maintain the free market to the 20% threshold. However, if a person acquired any shares on escalation terms, that person could not also have the benefit of mounting a partial bid for the shares in the relevant company.

[74] RECOMMENDATION 3

That a person be prohibited from making a partial bid if by reason of the making of the bid or any acquisition of shares under it, the bidder or any associate would incur any obligation to make a payment or provide any other consideration under any pre-existing escalation agreement.

Price Equity

[75] Under existing rules, intending partial bidders may acquire shares in the pre-bid period at a price unrelated to the later bid price. Bidders may use this to advantage by offering to acquire particular shareholdings at a substantial premium to the intended bid price. This lack of price equity further highlights the possible disparate treatment of target company shareholders by the bidder and the pressure that may be placed on shareholders to dispose of their shares to the bidder prior to the bid.

[76] The Committee considers there is merit in introducing greater price equity by obliging partial bidders to reflect pre-bid prices in any cash bid price. The Committee notes that under takeover announcements the specified cash bid price must be no less than the highest price paid by the bidder or its associates for target company shares in the prior four months: CASA s17(6)(7). There is no equivalent minimum price obligation for bidders undertaking takeover offers, which includes partial bids. The Committee views this result as anomalous and favours introduction of a price equity rule for all cash and cash alternative takeover offers, including but not confined to partial bids. Accordingly, the Committee's recommendation is in general terms.

[77] RECOMMENDATION 4

That the minimum price requirement formula set out in CASA s17(6)(7), and which at present applies only to takeover announcements, be applied also to takeover offers where the consideration consists wholly of cash or contains a wholly cash alternative.

[78] Proposition 4: If the proportional bid proposal is not adopted, the maximum offer period for a partial bid should be one month with the consequential prescription of the time within which the consideration for a partial bid should be paid, and this period should not be capable of being extended.

[79] The principal argument in favour of a restricted bid period is that it adds to the level of shareholder confidence by lessening the period of uncertainty regarding possible success of the bid and use of the pro-rata mechanism. However, a restricted offer period may be unnecessary if the Committee's recommendation to confine partial bids to proportional bids is adopted. Shareholders who accept a proportional bid will be entitled to deal with the residue of their shares without having to wait to the end of the bid period. Furthermore a restricted offer period may create a number of problems:

* There are difficulties regarding timing of counter bids. A restricted period may not allow sufficient time for a counter bid to an unexpected partial bid to be prepared, registered and formally announced before the initial bid closes. This may have the result of lessening or discouraging competition between bidders and therefore act to the detriment of shareholders.

* The inability to extend the period of a bid when faced with a counter bid may lessen competition and discourage the emergence of an auction for the target company's shares.

* A restricted offer period may limit or remove the ability of the initial bidder to respond to late information by raising the price and extending the offer.

[80] To overcome many of these difficulties, it may be necessary to introduce a further provision that the fixed period be capable of extension in certain instances e.g., where a rival bid emerges or the bidder wishes to vary his offer. These introduce further complexities and would have to be closely monitored to ensure that bidders do not resort to artifices to extend the offer period.

[81] A restriction on the bid period suffers the additional shortcoming of not addressing directly the potentially coercive elements in partial bids that have been identified. It therefore does not directly and effectively
respond to existing shortcomings in the regulation of partial bids.

[82] For these reasons the Committee does not support any alteration of the maximum period for partial bids, and favours retention of the current rule that this period be the same for partial as for full bids.

[83] Proposition 5: Any provision in the constituent documents of a company listed on the main board of a Stock Exchange limiting the right to acquisition of shares pursuant to a partial bid made in accordance with the legislation be declared ineffective.

[84] This possibility was a response to what is commonly known in overseas jurisdictions as 'shark repellant' provisions in the Articles of Association of target companies. Typically these require approval being given by a stipulated percentage of independent shareholders before acceptances may be made pursuant to the bid.

[85] The Committee is not persuaded that a provision of the kind postulated in Proposition 5 is desirable. It agrees that in general it should lie within the discretion of shareholders to include in their articles provisions that relate to partial bids. It was strongly argued in some submissions that a shareholder plebiscite article would allow shareholders to act in a more cohesive manner and increase their bargaining power in the face of partial bids. Shareholders would have less to fear by opposing a coercive front-end loaded bid or a bid which did not offer an adequate premium for control.

[86] A plebiscite provision in the articles may also allow shareholders to separate out considerations of the desirability of the bid and whether to participate in it. This separation would be even clearer under proportional bids where a shareholder would be aware that by voting in favour of the bid he would be entitled to offer only the stipulated proportion of his shares to the bidder, and by so doing may become a locked-in minority.

[87] A shareholder plebiscite may also lessen or avert the possibility of an acceptance stampede, as shareholders may choose to reject the bid itself while simultaneously accepting for their shares. This would allow shareholders to oppose a bid without fear of forfeiting an opportunity to sell a proportion of their shares to the bidder should the bid prove successful. A plebiscite provides shareholders with a 'costless' independent vote on the merits of the bid.

[88] The Committee recognises that a shareholder plebiscite article would constitute an exception to the principle that shares in listed public companies be freely transferable. However, this is counter-balanced by the benefits such articles may provide in lessening the coercive effects of partial bids. Furthermore, in determining whether

to adopt plebiscite articles, shareholders will have to take into account the possible adverse effects such articles may have on the market price of their securities.

[89] While supporting the principle of shareholder plebiscite articles the Committee places a number of important qualifications on their use:

(1) It is essential to ensure that shareholders are provided with full information on the reasons for and the implications of adopting a shareholder plebiscite article. The Committee considers that the matters set out in para 39 of the Discussion Paper should be regarded as an absolute minimum. The Committee favours inclusion of such requirements in the listing rules of the stock exchanges.

(2) There should be a degree of uniformity in the content of such articles in order to avoid shareholder confusion and the possibility of abuse. The principles governing the content of plebiscite articles are set out i~ Recommendation 5.

(3) All shareholder plebiscite articles should have a 'sunset' clause not exceeding three years duration. The composition of the shareholders of listed public companies is continually changing and it is the binding of successors which is of particular concern to the Committee. Accordingly, a shareholder plebiscite article should automatically lapse unless renewed at least every three years by special resolution.

(4) Such articles would remain subject to relevant statutory provisions e.g. Companies Code s125-126, which may, in particular instances, inhibit or constrain their use.

[90] At a more general level the Committee recognises that the Stock Exchanges will have an interest in the content of shareholder plebiscite articles of listed public companies, and believes that they should monitor such articles in the first instance to guard against abuse. Legislation dealing with such articles could be considered at some later stage should abuses arise.

[91] The Committee does not support the further step favoured in a number of submissions of making a vote for approval of a partial bid a mandatory element (cf. the London City Code Rule 36.5). It should be left to the discretion of the members whether to include a shareholder plebiscite in the articles. A mandatory shareholder plebiscite for all partial bids may introduce too strong a bias against them. The Committee has expressed its concern in this regard in the Discussion Paper Para. 42.

[92] RECOMMENDATION 5

That the Ministerial Council not disallow such alterations of the Listing Rules of Stock Exchanges as may be adopted in furtherance of the following principles:

(1) The constituent documents of a listed company may forbid the registration of share transfers resulting from a partial bid where the acquisition contemplated by the bid has not received shareholder approval in accordance with the following requirements;

(a) The approval required shall be the approval of such proportion (not exceeding a simple majority according to the number of shares held) as the constituent documents prescribe of those shareholders who vote pursuant to the adopted procedure.

(b) The bidder and its associates shall not be entitled to vote in these proceedings.

(c) The procedures for seeking approval shall be undertaken by the target company itself and may be by way of resolution at a general meeting or by ballot conducted independently of a meeting.

(d) The procedures must be completed and the result announced through the home exchange within a reasonable time before the closing date of the partial bid.

(2) Any proposal to insert in the constituent documents of a listed company a provision of the kind referred to in paragraph (1) must be accompanied by materials which:

*** Explain the reasons for the proposed article and the factors and principles supporting or serving as a foundation for the reasons stated;**

*** State whether the proposal is the result of management knowledge of a specific attempt to take over the company;**

*** Describe the overall effect of the amendment;**

*** Discuss its advantages and disadvantages for both management and shareholders.**

(3) Any such provision in the constituent documents of a listed company shall not continue in force for more than three years after its adoption, but may be renewed in the same manner as applies to its adoption.

The Non-Assenting Tender

[93] An alternative form of 'shareholder plebiscite' provision called a 'non-assenting tender offer', has been proposed in a paper by Professor J. C. Coffee of Columbia University Law School (delivered at a University of New South Wales/University of Sydney Seminar - July, 1985). The proposal is, in essence, that the bidder would have to receive, in a separate ballot, the affirmative vote of shareholders in a number not less than the number of shares sought under the partial bid (but never more than 50%). If the votes in favour of the offer at least match the percentage of the issued capital targeted by the partial bidder, the offer may proceed and acceptances are pro-rated according to the number of shares offered.

[94] This proposal, like other forms of shareholder plebiscites, is designed to allow shareholders to separate out considerations of the merit of the bid and whether to participate in the event of it being successful. However, the non-assenting tender proposal differs from the Committee's recommendations in two major respects:

(1) The non-assenting tender proposal prescribes a necessary acceptance level, being the proportion of the total shares sought under the bid (but never more than 50%), whereas the Committee's recommendation provides for a simple majority of votes cast on the merits of the partial bid.

(2) The non-assenting tender proposal envisages pro-rata as well as proportional bids whereas the Committee favours proportional bids only.

[95] Common to both approaches is that the bidder and its associates are prohibited from voting on the merits of the bid.

[96] The Committee is of the view that notwithstanding the merits of the non-assenting tender proposal, it should not be preferred to a simple majority plebiscite for the following reasons:

* A partial bid, of whatever magnitude, may have fundamental short and long term effects on the target company. It would seem more equitable to allow a majority of independent shareholders of the target, who choose to vote, to determine the success of the bid, rather than leave this decision to a minority or stipulated percentage of the target company shareholders.

* Introduction of non-assenting tenders may encourage 'front-end loaded small bite' bids which involve, in effect, some of the same coercive mechanisms as may be found under current rules regulating partial bids.

[97] Proposition 6: a member of the company be enabled to apply to the Court for an order that the allotment of any share capital be avoided where the issue is related to the acquisition by any person of a substantial interest in the company unless the company shows that the issue was in the interests of the members of the company as a whole.

[98] This proposal was a response to what has become known in overseas jurisdictions as 'poison pill' defences which may be described as the potential issue of new share capital on terms that discriminate against the interests of a bidder in the event of an unwelcome bid. For instance, the system of linked options involves shares being issued to shareholders other than the bidder or its associates if a partial offer fails to be approved by a majority of shareholders independently of the offer.

[99] The Committee wishes to reiterate its concern about the use of 'poison pill' defences; in particular that such share issues may have nothing whatsoever to do with the company's need for additional equity funds and may have little relevance to the economic interests of shareholders as a whole.

[100] The Committee does not, however, favour the adoption of proposition 6. Its reasons are as follows:

* It may unreasonably reverse the onus of proof. The proposal would place the onus on the incumbent Board of Directors to establish that the share issue was in the interests of the company. It may not be appropriate to single out this type of activity for reversal of the onus, in comparison with other possible abuses involving takeovers where the onus remains on the complainant, e.g. CASA Section 50(4).

* Even if the onus of proof problem was resolved, the provision may be unnecessary. Dissenting shareholders are already entitled to seek a remedy for an improper share issue at common law or pursuant to the oppression provisions of the Companies Code e.g., s320(1) (a) (ii). In addition, the allotment of share capital by listed public companies is already regulated by various listing requirements: 3E(6); 3E(8); and most importantly in this context 3R(3). This may suffice to remedy abuses. However, should these remedies not prove effective it may be necessary to introduce specific legislative provisions dealing with poison pill defences.

[101] The Committee therefore favours reserving consideration of any further regulatory response to 'poison pill' defences until such time as any abuses might emerge.

Committee Members

H.A.J. Ford (Chairman)
R.I. Barrett
D.A. Crawford
A.B. Greenwood
K.W. Halkerston

Research Director

J.B. Kluver

August, 1985.

APPENDIX 1

COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

DISCUSSION PAPER NO. 2
PARTIAL TAKEOVER BIDS

MARCH 1985

COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

The Companies and Securities Law Review Committee was established late in 1983 by the Ministerial Council for Companies and Securities pursuant to the inter-governmental agreement between the Commonwealth and the States on 22 December 1978.

The Committee's function is to assist the Ministerial Council by carrying out research into and advising on, law reform in relation to legislation relating to companies and the regulation of the securities industry.

The Committee consists of five part-time members, namely:

Mr. Reginald I. Barrett
Mr. David A. Crawford
Professor Harold A.J. Ford (Chairman)
Mr. Anthony B. Greenwood
Mr. Keith W. Halkerston

The full-time Research Director for the Committee is Mr. John B. Kluver.

The Committee's office is at Level 24, MLC Centre, 19-29 Martin Place, Sydney, New South Wales, 2000.

GENERAL AIMS OF THE COMMITTEE

To develop improvements of substance and form in such parts of companies and securities law as are referred to the Committee by the Ministerial Council and to that purpose to develop proposals for laws:

* which are practical in the field of company law and securities regulation;

* which facilitate, consistently with the public interest, the activities of persons who operate companies, invest in companies or deal with companies and of persons who have dealings in securities; and

* which do not increase regulation beyond the level needed for the proper protection of persons who have dealings with companies or in relation to securities.

In the identification of defects and the development of proposals to have regard to the need for appropriate consultation with interested persons, organisations and governments.

The Reference from the Ministerial Council

The Committee has received a general reference from the Ministerial Council to enquire into and review the question of the appropriateness of the Companies (Acquisition of Shares) Act 1980 as a mechanism for regulating takeovers in Australia.

The Committee has decided to consider first, the matter of partial takeover bids, as these bids appear to provide a focus for some general policy issues and to be the area of main concern in connection with the operation of the present legislation.

Aim of This Discussion Paper

The Committee's aim in preparing this paper is to raise for consideration by interested persons, the issues relating to partial takeover bids where the operation of the present legislation has been suggested to be inadequate, and through provision of an empirical study to provide evidence relevant to discussion of those issues.

The paper is in no sense a draft report. The paper adverts to possible changes in the law at this stage for the limited purpose of stimulating thought on specific issues by persons likely to be interested in the regulation of partial takeover bids.

The Committee has consulted Professor Peter Dodd of the Australian Graduate School of Management at the University of New South Wales, who has undertaken a study of the returns on takeovers, which is contained as an Appendix to this paper.

Invitation for Responses

The Committee invites interested persons to give to the Committee their written response on the issues raised in this paper.

The Committee will assume that it is free to publish any response, either in whole or in part, unless the respondent indicates that the response is confidential. In any event, all respondents will be listed in the Committee's report to the Ministerial Council.

Replies should be sent to: The Research Director, Companies and Securities Law Review Committee, Level 24, MLC Centre, 19-29 Martin Place, Sydney, 2000 by Monday 6th May, 1985.

COMMITTEE DISCUSSION

PRESENT LAW

The Companies (Acquisition of Shares) Act ("CASA") contains only three rules which distinguish between offers designed to acquire all of a company's voting share capital and only part thereof.

2. The rules specific to the latter ("partial bids") are:

(1) The on market takeover announcement procedure is not a permitted technique (CASA section 17).

(2) An offeror making a partial bid who is already entitled to 20% of the voting capital may not make ordinary market purchases after registration of his Part A Statement (a restriction which however is also imposed on bids for all voting shares if consideration is not cash or certain conditions are attached to the offers) (CASA section 13(3)-(4)).

(3) If the offeror frames his offers so that all offerees may tender all their shares, resulting in a larger volume of shares tendered than that sought by the offeror, acceptances must be pro-rated ("pro-rata offers") (CASA section 26).

3. Thus the salient rules relating to partial bids in the context of general takeover regulation are:

* The bid may be constituted by offers for a specified part of each shareholder's holding, or for all or part of the holdings of each shareholder up to a specified maximum proportion of the capital of the company (CASA section 16).

* The offeror may acquire any voting shares in any manner before service of his formal documentation (Part A Statement) on the target company so long as the entitlement of any person does not exceed 20% as a result (CASA section 11).

* After service of the Part A Statement the offeror may acquire further shares otherwise than pursuant to the terms of the bid but only in the ordinary course of market trading and only until his entitlement or that of another person reaches 20% as a result, (CASA sections 11, 13, and 4)).

* The prices paid for, or other terms of acquisition of shares before service of the Part A Statement need not bear any relationship to the price or consideration specified in the takeover offers (CASA section 16), but any price increase given for shares acquired thereafter operates as a variation to the terms of the bid (CASA section 31).

* In the case of pro rata offers the offeror may not elect to keep all or additional shares tendered above the proportion specified in his original offer (CASA section 26).

* The volume of shares tendered must, in the case of listed companies be publicly notified each day as the offeror's "entitlement". (CASA section 39) If acceptances received exceed the maximum proportion of the share capital that has been sought the offeror will notify an entitlement to a greater proportion of shares than that of which he will ultimately become the beneficial owner after pro-rating.

* If the offers have been open for the prescribed minimum period (presently 14 days) the offeror may withdraw all outstanding offers at any time, and apply the pro-rating procedures only to such shares as have been tendered at the time of withdrawal (CASA section 21).

* If the offer is for a proportion of each offeree's shareholding a shareholder may tender that proportion and sell the balance of his holding; on one view the new shareholder may also tender the specified proportion of the remaindered parcel (CASA section 25).

* In the case of pro rata offers, a shareholder will not know until after close of the offer period what proportion of his tendered shares have been taken up; the offer period may moreover be extended initially to six months and even to twelve months (CASA section 27).

CRITICISM OF THE PRESENT RULES

4. On the assumption that the legislative regulation of bids for the whole or part of voting capital of a company has as its principal purpose the achievement of an appropriate balance between the interests of acquirers and those of the general body of target company shareholders where market mechanisms would not be adequate for that purpose, the effect of the present rules has been criticised as being too favourable to acquirers.

5. These criticisms, which are not universally accepted as valid, relate to the principles of equal opportunity and participation in the premium for control, to commercial certainty and investor confidence, and to the effect of the pro rating mechanism. This paper now discusses the criticisms in relation to each principle. It may however be noted at the outset that in the light of the frequent calls for takeover legislation to be observed in accordance with its spirit and intent as well as detailed rules, it would be highly desirable for the fundamental purposes of the legislation to be specified clearly as a guide to interpretation.

(a) Equality of Opportunity and the Control Premium

6. The price margin in a takeover offer over what might otherwise be paid for the shares is described as the control premium. It should also be viewed as a single aggregate amount, in the sense that if it is spread among all shares, the price per share might be reduced from what might be paid in the case of control obtained through acquisition of only some of the shares.

7. A fundamental objective of takeover regulation has been the achievement of equality of opportunity as between shareholders; this is frequently related to the principle that all shareholders should have an equal opportunity to share any premium for control (see for example NCSC Release 101, paragraph 2(iii)).

8. It has been suggested that a partial bid will almost inevitably be a bid for so much of the voting capital as will confer practical control (the obtaining of control being the purpose of a bid); and that since the bid is for less than all capital the bidder is likely to set the price per share at a level that includes the full value to him of that control. (While it does not necessarily follow that the per share premium is likely to be higher for a partial bid than a full bid, it would seem that an offeror making a partial bid must have a competitive advantage over an offeror making a full bid because of the lower financial commitment).

9. Given that control passes upon the success of a partial bid, the value of remaining shares must be reduced, since they will have been stripped of what would otherwise be their proportion of the control premium which is now vested in the control parcel of stock. The incentive to the controller to acquire other shares and the price he may be prepared to pay will depend on the extent of inconvenience which external holders present to his plans for management of profits and dividends.

10. On this theory it is irrelevant that the fortunes of the company, and thus its share price, may improve under the new management. If the bid is successful the control premium will have passed. If the premium is to be paid on only some shares it is imperative that all shareholders should have equal opportunity to participate in the passage.

11. It has been suggested that the current rules unequally favour the opportunities of large shareholders, who are likely to be approached by an intending offeror who desires to acquire a strategic holding before making a partial bid and who may sell the whole of their shares (often subject to price escalator) without risk of pro-ration.

12. It has been further suggested that a partial bid where pro-rating will apply presents a powerful psychology for acceptance (described by some as "coercion") in that offeree shareholders must compete among themselves. Each accepting shareholder hopes that as many as possible of his co-investors will not accept so that his own returns may be maximised, and no shareholder hoping to maximise current returns can afford to reject the offer. Failure to accept may result in permanent loss by reason of transfer of the control premium otherwise inherent in all voting shares t_9 the shares acquired from those who do tender. One commentator has suggested that "because experience has shown that the after market is usually very poor bidders have learned that they do not need to provide a large premium in the partial offer to generate the stampede of acceptances. In fact the least desirable bidders can pay the lower premiums because the after market of the targets under their control will be weakest". [1]

13. Recommendations from the board of directors or expert advisers not to accept a bid which is less than adequate may moreover disadvantage those who follow such advice, thus placing those whose responsibility it is to advise shareholders in an invidious position. The ordinary advantage enjoyed by the professional investor over the small shareholder is thus magnified in this situation as the former is better placed to determine his course of action in the light of the daily information on flow of acceptances.

14. A related phenomenon of takeover practice in the United States (uncommon but quite practicable in Australia under current law), is the two stage acquisition, where after a successful partial bid a second and lower bid is made for the balance of the capital. A possible variant in Australia might be a three stage bid, in which the highest prices are paid selectively for the first 20% of the shares, followed by bids at successively lower prices. Should such staged bids emerge as a practice in Australia it would conclusively demonstrate the validity of the view of those who suggest that all shareholders should always tender in response to a partial bid made at a premium over current market price.

15. While the selective acquisition of strategic shareholdings below the 20% threshold gives rise to obvious concerns about equality of opportunity, it is not so clear that it is accurate to characterise the incentive to tender in response to a partial bid as in itself a loss of equality of opportunity. That seems to stretch the concept further than the words will easily bear in the context of the present legislation. The principle of equal opportunity at issue here may be expressed as being that the opportunity to participate in the value of any control premium should as far as practicable be proportionally available to all shares (as distinct from shareholders). To uphold such a principle of equal opportunity it is first necessary to assume that a proportional right to corporate control is inherently attached to voting shares (i.e. that control is a corporate asset). Only if it is expressly recognised that a proportional right to the value of control is one of the incidents of a share it is possible to determine what constitutes reasonably equal opportunity to obtain that value.

16. Once the principle of proportional right to any control premium is clear, it can be convincingly argued that the current rules on partial bids may not apply a proper balance between offerors and shareholders, on the grounds that not only does the acquisition of all the holdings of some shareholders before the bid clearly fail to serve the principle of equality of opportunity, but since the value of the control premium may under a pro-rata partial bid be stripped from some shares and accumulated disproportionately in others, what is offered is more a threat than an opportunity.

17. This paper favours recognition of control as a corporate asset. The case for any control premium to be vested proportionately in all shares is based on fundamental notions of fairness and equity: a share is a proportionate interest in the enterprise, and no aggregation of shares ought fairly claim entitlement to a value derived from the enterprise greater than the sum of the individual value of each share.

18. The strongest support for this case comes in the writings of Professor David Bayne S.J. [2] - although he is primarily concerned with sale by a controller - and of Professor William Andrews [3]. The Andrews position was restated by A.B. Greenwood as an NCSC view in a paper to CEDA in March 1982.

19. The case against maintaining such concepts of equity is usually put by economists, who tend to view securities as a market commodity separate from the proportionate interest in the enterprise which they represent. At its highest the argument of the economists runs along these lines - the price of securities will reflect adequately the possibilities of unequal

distribution of gains, and investors who want equal returns can buy government securities or hold diversified portfolios; to attempt to provide more equal distribution of gains will make takeover bids more expensive and therefore less frequent, and this does not assist the welfare of holders of the securities.

20. While having some theoretical appeal, the idea that a "free" market will adequately reflect the possibility of unequal gain is far from proven, and the robust advice to those who cannot stand the heat to stay out of the kitchen is not calculated to foster investor confidence or direct participation in the securities markets by ordinary, i.e. small, investors. The theory that application of a principle of sharing the control premium among all shares will lessen takeover prospects remains unproven: the answer must be that it depends on the circumstances of each case.

21. Ultimately considerations of equity or fairness must have priority over those of mere price efficiency if there were an irreconcilable conflict between the two. In the present case however, the economic argument for price efficiency seems primarily an argument in favour of potential cost savings for bidders. Nevertheless the value judgement concerned is of such importance that the legislature should not leave its resolution in doubt in legislation such as CASA, which necessarily involves a substantial degree of discretionary administration: the time has probably come to confirm one purpose of the legislation as being to ensure that as far as reasonably practicable any premium value for control of a company should be at all times proportionately vested in each voting share.

(b) Other Issues Relating to Equality of Opportunity

22. The principle of equality of opportunity among shareholders would be clearly impugned if takeover offers were withdrawn earlier than the time specified in the offer document and the offeror retains shares tendered. This case may be fairly described as an abuse, and dealt with accordingly by the NCSC using its power to declare conduct unacceptable.

(c) Commercial Certainty and Investor Confidence

23. It is a necessary implication of a pro rata partial bid that shares tendered cannot be taken up by an offeror until the close of the offer period, since it will not be apparent until then what proportion of each tender is to be taken up. Thus shareholders cannot know until that time how many of their shares have been sold, and the matter is further complicated in that the offer period may be extended at the instance of the offeror. In this period shareholders cannot deal with the "balance" of their holdings.

24. Moreover, if the partial bid is unconditional there may be an irreconcilable conflict between the rule that consideration must be paid within 30 days of acceptance (CASA section 16(2)(f)(vii)(A)) and the implications of the rule requiring pro ration of acceptances (CASA section 26) as this can only occur after close of the offer period.

25. Technical problems may also arise on pro ration in connection with odd lots, particularly for institutional nominee companies which hold shares for multiple separate accounts.

26. The whole process of pro-ration as an appropriate policy is called in question below. In the event that pro-rated offers remain permissible under the legislation, the possibilities of extension of the offer period, conflict over due date for consideration, and the position of nominee companies, clearly detract from certainty and confidence; although not common occurrences each attracts the need for specific amendment.

OVERSEAS APPROACHES TO PARTIAL BIDS

27. The contrasting approaches to partial bids adopted in the United Kingdom and North America shortly encapsulate the polarities of viewpoint on the subject of partial bids and the essentially political policy choice which must be made.

28. Under the City Code on Takeovers and Mergers which regulates takeover bids for public companies "resident" in the United Kingdom:

* No partial offers may be made without consent of the Panel, but this is usually given if the offeror would emerge with less than 30% of voting capital. (The consent is forthcoming because the basic bid threshold under the City Code is 30%.)

* Restraint is placed on share purchases by the offeror or persons acting in concert both during the offer period and for a period of 12 months after and, if the offeror would hold more than 30% of voting capital after the offer,

consent will not normally be granted if shares have been acquired selectively or in significant numbers during the preceding 12 months.

* Where the offeror's eventual holding would be more than 30%, the offer must be conditional upon separate approval being given by shareholders, independent of the offeror, who hold over 50% of the voting rights.

* Where the eventual holding would be between 30-50%, the offer may not be declared unconditional as to acceptances unless acceptances are received for at least the desired number of shares.

* Where there is more than one class of equity capital and the offeror would ultimately hold more than 30% of one class, comparable offers must be made for each class.

* Where the offeror's holding would exceed 50% of the target's capital at the close of the offer, the offer documents must state that, if the offer is successful, control will pass to the offeror who will be free to exercise that control and acquire further shares without incurring obligations under the code.

* Pro rating provisions apply.

29. In the United States of America and Canada partial bids are, as in Australia, subject to few specific rules additional to those applicable to any takeover scheme. In the United States of America the subject has been recently examined by the SEC Advisory Committee on Tender Offers (Report dated 8 July 1983), and since its report is one of the few official documents to discuss policy issues and principles, and the relevant section is succinct, it is quoted in full:

"B. Partial Offers and Two-Tier Bids

Current regulations under the Williams Act make little distinction between full offers and partial offers. The relatively recent phenomenon of the two-tier or front-end loaded bid likewise has not been subject to different regulation. The Committee considered at length whether partial offers and/or two-tier bids should be distinguished under the regulations from offers to purchase all shares, and, if so, whether the partial offer and/or the two-tier bid should be prohibited o~ simply disadvantaged under the regulations.

There is substantial sentiment on the Committee that, so long as there is equal opportunity for all shareholders to participate in all phases of each bid, the laws should not distinguish among various types of bids. Those favouring no change in the current system argue that the preservation of partial tender offers is important to the working of the economy and that there are many valuable roles for partial offers and partial ownership, including

(1) allowing companies to invest in one or more industries with more limited financial exposure than if the ownership were 100%;

(2) facilitating technology exchange relationships;

(3) permitting change of control and reducing management entrenchment in large companies;

(4) facilitating private direct investment, such as venture capital;

(5) acknowledging the common practices of suppliers of foreign capital in the United States; and

(6) allowing acquirers to get to know a potential acquiree over time with a view to moving to 100% ownership.

These members posit that if partial bids therefore are permitted, two-tier bids should not be precluded, since as a practical matter such bids are more favourable to target company shareholders than partial offers with no second step. In such two-tier bids, a second step at a lower price than the first step normally is at a premium to the unaffected secondary market absent any second step.

The majority of the Committee, however, did not believe that the reasons advanced for equal treatment of full, partial and two-tier bids completely outweighed a concern with respect to coercive elements of partial and two-tier bids and the potential such bids provide for abusive tactics and practices. While some would have prohibited such bids altogether, the Committee determined to recommend a regulatory disincentive for partial offers and two tier bids. Such disincentive would be provided by requiring a longer minimum offering period for partial bids than that required for full bids.

Recommendation 16

The minimum offering period for a tender offer for less than all the outstanding shares of a class of voting securities should be approximately two weeks longer than that prescribed for other tender offers.

The Committee gave considerable thought to adoption of requirements similar to those provided in the British City Code on Takeovers and Mergers, i.e. restrictions on open market purchases above 15% and the general obligation to make an offer for all shares if the amount owned or sought exceeds 30% of the outstanding shares. Adoption of such a system in effect would preclude a number of significant partial offers and generally would require share purchases above a defined amount to be accomplished through a tender offer for all shares - for cash or securities or a mix thereof - at the same or different values. An essential corollary would be the elimination of supermajority and fair value charter provisions, and the adoption of a 'non-frustration' doctrine to govern the actions of target management. While the British system has considerable attractions, the Committee determined that a more

evolutionary development was appropriate, particularly in view of its conclusions concerning partial offers. In the event that the recommendations of the Committee do not have the desired effects, however, the Committee suggests that the Commission reconsider incorporation of some features of the British System.

OPTIONS FOR REFORM

30. The purpose of regulation of partial bids must primarily be to remedy market imperfections in the interests of shareholders; claims for incumbent controllers, at least in the Case of companies listed on the main boards of stock exchanges, for a right to stability of the share register should be treated with some skepticism. Defects which have been identified must be balanced against the opportunities provided by such bids and the benefits flowing from partial bids as identified by the SEC Advisory Committee should be given full weight. The choices (other than no action or further movement towards unrestricted market operation) appear to be:

(a) Restrictions on Partial Bids Generally

31. If the imperfections of the mechanism for a partial bid are thought to outweigh the opportunities it presents for additional investment opportunities for shareholders, then provisions along the general lines of the City Code on Takeovers and Mergers might be introduced into the Companies (Acquisition of Shares) Act to the extent these do not already form part of the legislative framework.

32. Since a cornerstone of that form of regulation is that regulatory consent is required for partial bids above the threshold, one issue in the Australian context is whether, if this option were to be favoured, this form of regulation should include the vesting of a specific consent discretion in the NCSC, and if so whether the legislation should include guidelines for grant of such consent along the lines of those which appear on the face of the City Code together with any additional matters. The alternative would be to prohibit partial bids except in specified circumstances, (i.e. those where the City Code requirement would be satisfied) but subject to the general exemptive powers of the NCSC expressed in sections 57-59 of the legislation.

33. A purely discretionary approach in the Australian system must be seen as unattractive - involving as it would a merit judgement on the fairness of each individual bid. It is nevertheless plain that the operation of the threshold may confer an opportunity advantage on some shareholders by affording them an exemption from the pro-rating provisions. There is a conflict between the principle that acquisitions not giving rise to control should not be regulated and the principle of equal opportunity in relation to pro-rated acquisitions. This conflict can only be completely resolved by reducing the threshold to 0% in the case of partial bids. A compromise position might involve adopting the City Code rules prohibiting a partial bid within a specified period after significant acquisition, and follow up bids. A more direct and ultimately simpler approach would be a substantial, but not absolute, reduction in the threshold. Such provisions may be supported bearing in mind that in the Australian context the NCSC would retain an exempting power in respect of these restrictions as with all others in the legislation, to be exercised in accordance with the guiding principles of the Code.

34. The Committee has furnished a separate Report to the Ministerial Council on the Takeover Threshold. In the course of preparation of that Report views were sought as to whether the threshold for partial bids should be reduced to say, 15% or 10%. A substantial majority of respondents disagreed with this proposition, but the matter deserves further consideration. A downward adjustment of the threshold would not only enhance equality of opportunity in relation to holdings acquired but could also contribute to the amelioration of some of the coercive effect that is associated with a bid for control to be acquired through only some shares, because a lower starting point could affect the bargaining power of the offeror to a quite significant degree by facilitating the emergence of competitive offers.

35. The most significant feature of the provisions of the London Code is that where the offeror's eventual holding would be more than 30% an offer must be conditional upon approval being given by shareholders, independent of the offeror, who hold over 50% of the voting rights. In other jurisdictions provisions to this effect have been inserted in the articles of association of potential target companies, and have become known as "shark repellants". Proponents of such a requirement for approval (including many in Australia), whether given at a meeting of shareholders or by some form of plebiscite in the course of a bid, frequently suggest that it is a "free market solution", but such a hypothesis begs almost as many questions as it answers.

36. In a recent article [4] Leo Herzel and John R. Schmidt suggest two possible reasons in favour of a requirement for shareholder approval:

* it would enhance the directors' bargaining power in connection with any potential sale of the enterprise; and

* corporate management would be improved by eliminating the possible threat of hostile takeover through being able to undertake longer term planning, the beneficial effects of which cannot be directly measured in economic terms.

(A further possible rationale suggested by a Study of the Office of Chief Economist of the Securities and Exchange Commission [5] (the "SEC Study") is that management will try to protect its job in one way or another, and such amendments will benefit shareholders because they will discourage other, more costly, maneuvers.) The authors of the article suggest that if the advocates of the benefits of unrestrained hostile takeover bids are correct, shareholders would never vote for such provisions (to be inserted in the articles of association) of if they did the value of their shares would be adversely affected. A similar argument would of course apply to the approval of the bid itself - shareholders would never refuse. In either case it is implied that there can be no harm in giving shareholders the option.

37. The most persuasive argument in favour of a requirement for shareholder approval of a bid is however one noted by the SEC Study. The SEC Study suggests that if it be assumed that a takeover will result in a sharing of wealth between offeror and

target company shareholders, the position of the latter is stronger the more cohesive they are in determining their response, and a requirement for approval can force shareholders to act in a more cohesive manner. Where they know a bid will only be successful if a specified majority of shareholders accept the offer, they have less to fear by not tendering to any offer which they think is too low. Presumably the fail-safe procedure is to accept the bid but vote against it - but this may require a level of sophistication beyond what may be expected of the ordinary voter.

38. However, observation of recent Australian experience of approval proposals presented to shareholders meetings, including meetings which have considered acquisitions, pursuant to paragraph 12(g) of the legislation, does little to inspire confidence in the route of shareholder ratification as a valid means of expression of informed shareholder will. It must be recognised that it is difficult to provide adequate disclosure for such purposes, particularly as disclosure has obvious psychological limits in this area. Directors whose motives are improper, i.e. if they are more concerned with preserving their incumbency than acting in the best interests of the shareholders as a whole body of investors, are unlikely to disclose to a meeting the unfairness of their behaviour.

39. In the USA any proposal to insert a restrictive amendment of this kind into a company's articles must be accompanied by proxy materials which:

* explain the reasons for the shark repellants and the bases of the reasons including the factors and/or

principles supporting or serving as a foundation for the reason stated;

* whether the proposal is the result of management knowledge of a specific effort to take over the company (and if not, why the measure is being proposed);

* describe the overall effect of the amendment;

* discuss its advantages and disadvantages for both management and shareholders.

Such disclosure should be also regarded as the absolute minimum for shareholder adoption of any such scheme in Australia. In 1979 the SEC warned that shark repellant amendments appeared to be inconsistent with the protection of investors and the congressional purpose underlying the Williams Act. However, the SEC Advisory Committee on Tender Offers in its Report recommended only that such shark repellants be approved periodically, i.e. at least once every three years. More recently the SEC Study has established empirical evidence that charter amendments lower the stock price of the company.

40. The fundamental objections to the inclusion in the articles of association of a provision requiring a vote of shareholders for approval of a particular takeover, whether or not it is periodically reaffirmed at a shareholders meeting, are firstly that it is inconsistent with the principle that a share in a public company should be transferable without consent of other

shareholders and secondly that because the reasonable shareholder must diversify his investments as a means of spreading risk, he frequently lacks a sufficient financial interest in any particular company to have an incentive to determine whether the proposal is appropriate. Both the cost of a meeting and the incumbents control of the proxy process render an outcome rejecting such proposals unlikely. As the SEC Study notes, there are two hypotheses which make success of such resolutions likely. One possibility is that there is a group of shareholders (institutions) which gains by working with incumbent managers. These shareholders may have a deciding balance of voting power. The second possibility is that ordinary shareholders have relatively high information costs in determining the impact of the resolution on their wealth. They may find that in general their wealth is maximised by agreeing with the resolutions proposed by the incumbent board rather than expending resources to predict the effects themselves.

41. A legislative requirement for shareholder approval to a partial bid along the lines of that required by the City Code would of course go much further than the "free market" hypothesis which has been advanced to justify the insertion of such provisions into the articles of companies. While the free market hypothesis itself suffers from the defect that it penalises shareholders who not unreasonably fail to anticipate a subsequent failure of the board of directors to fully discharge their fiduciary obligations, the incorporation of such a requirement in the legislation would signal a significant policy bias against partial bids. That bias is not supportable upon the economic evidence provided in the Appendix of this Discussion Paper as being in the interests of investors generally.

42. A vote on approval of a specific bid suffers similarly from a bias in favour of the incumbent board. If the target company board opposes the bid, stating that the shares are worth more, the voting mechanism must for the reasons outlined above strongly favour an outcome rejecting the bid. Where the specified requisite majority is absolute, shareholder apathy also works for incumbent control in this context. A shareholder approval requirement may thus be merely a tactic giving only the illusion of freedom and fairness which diverts attention from the main issues - the economic benefits of the takeover, the equality of opportunity for all shares to participate in the control premium, and managerial self-interest. There is also something curious in a suggested "free" vote in which the associates of one side of the case are forbidden from voting, while the other side is free to rally as much opposition as it can in any manner it wishes. Finally, the argument for a free vote of shareholders assumes that the vote is based on knowledge, but current experience is that adequate disclosure for these forms of decision is the exception rather than the rule. It also has to be assumed that approval in fact provides an accurate reflection of shareholder wishes: an assumption which in the light of the normal proxy gathering and meeting process or in the case of a plebiscite, response process, must in many cases be unfounded.

43. It may be concluded that not only should there not be legislative provision restricting the making of a partial bid to instances where there is shareholder ratification of the bid, but in the case of companies admitted to listing on the main boards of stock exchanges there should be a positive requirement prohibiting the incorporation of such "shark repellant" provisions into the articles of association.

44. In the light of the foregoing discussion, a matter of even greater concern is the suggestion of defences of a kind similar to those known in the USA as "poison pills". These defences provide, in one form or another; for the potential issue of new share capital on terms that discriminate between the interests of a bidder in the event of an unwelcome bid. Such provisions are obviously an abuse: the capital issue has nothing whatever to do with the company's need for additional equity funds, and may have little to do with the economic interests of shareholders as a whole.

45. Such tactics by incumbent controllers should be sharply discouraged. To this end, the legislation should enable a member of the company to apply to the Court for the avoidance of any issue of share capital where the allotment is in its terms consequential upon the acquisition or proposed acquisition by any person of a substantial interest in the company unless it is shown that the allotment is in the interests of the members of the company as a whole. While this solution would depend on litigation of a difficult issue - "interests of the members of the company as a whole" - for its effectiveness, the onus on the board/company to justify the issue could act as some deterrent against the more blatant cases.

(b) Restriction of Partial Bids to Proportional Bids

46. Many of the criticisms of partial bids arise directly or indirectly in relation to the effects of pro-rating, since it is this element that supplies the coercive engine. The fewer shareholders that accept, the more likely it is that all

benefits will flow to those who do. Even though few offers in Australia have resulted in pro-rating, it is the threat of pro-ration which is coercive. Such coercion is not such a significant element in a partial bid made for a specified proportion of each shareholding because failure to tender does not inevitably imply a corresponding increment in the value to be received by shareholders who do tender. The arguments in favour of partial bids summarised in USA Advisory Committee Report (above) would in the main still be satisfied in the case of a proportional partial bid.

47. The case for a reform limiting partial bids to proportional bids has been argued at length by Dick Gross. [6] The logic and simplicity of such a requirement in meeting the various criticisms is strong especially when shareholder plebiscite proposals are rejected. On the other hand it may be thought that such a limitation could probably make a partial bid impracticable for an offeror who is aiming at a specific percentage holding in a company, such as 50.1%, since the leakage in acceptances would produce too great a margin of uncertainty in framing the bid. There is no doubt that under such a regime offerors would have to allow a margin over the minimum target (which could be underwritten by a minimum acceptance condition). Should the offer be more successful than desired, the offeror could dispose of the excess holding after close of the bid.

(c) Application of a Special Time Disincentive to Partial Bids

48. The solution of extended time as proposed by the USA Advisory Committee seems unlikely to resolve the criticisms of partial bids in an Australian context. The extended period could even add to market uncertainty and detract from investor confidence in Australian Markets.

49. A different form of time regulation of partial bids is prescribed under Ontario Law, under which the maximum time period for a partial bid is 35 days and the pro-ration and payment must be completed within 14 days of the close of the offer period; in a total bid, by way of contrast, while acceptances received at the end of the first 35 days must either be taken up or abandoned, there is no maximum time limit for the offer period.

50. If the proposal to eliminate pro-rata partial bids is not adopted, a short maximum period for a partial bid, e.g. one month, would at least enable many of the uncertainties relating to success and payment currently inherent in the pro-rata mechanism to be resolved within a reasonable time and may be supported accordingly.

SUMMARY AND CONCLUSION

51. This discussion paper has suggested that partial bids, while presenting shareholders with particular difficulties, also may be beneficial to investors. They should therefore not be subjected to further substantial restrictions beyond those consistent with securing reasonably equal opportunity for shareholders and directors to consider the bid and participate in those benefits without coercion.

52. The Committee seeks reactions to the question whether there should be adjustments to the legislation along the following lines:

(1) there be included in the legislation a clear statement of the basic objectives that it seeks to achieve, being the principles stated in sections 59 and 60, amplified by a further principle that as far as reasonably practicable the value of any premium for control should be at all times proportionately vested in each voting share;

(2) a partial bid be capable of being made only for a specified proportion of each shareholder holding;

(3) a partial bid not be permitted in the case where a person who is already entitled to 10% of the company's voting shares would increase his entitlement to more than 20% as a result of the bid;

(4) if the second suggestion above is not adopted, the maximum offer period for a partial bid should be one month with a consequential prescription of the time within which the consideration for a partial bid should be paid, and this period should not be capable of being extended;

(5) any provisions in the constituent documents of a company listed on the main board of a stock exchange limiting the right to acquisition of shares pursuant to a partial bid made in accordance with the legislation be declared ineffective;

(6) a member of a company be enabled to apply to the Court for an order that the allotment of any share capital be avoided where the issue is related to the acquisition by any person of a substantial interest in the company unless the company shows that the issue was in the interests of the members of the company as a whole.

53. If any adjustment to the present law is deemed desirable, the Committee believes that the necessary legislation should be introduced as soon as practicable, and proposes to so recommend to the Ministerial Council for Companies and Securities.

FOOTNOTES

1. A.R. Berg as quoted in BRW 15-21 October 1983

2. See for example The Sale of Control Premium: The Intrinsic Illegitimacy Texas Law Review Volume 47 (1969) 215.

3. The Stockholders Right to Equal Opportunity in the Sale of Shares (1965) 78 Harvard Law Review 505.

4. "Is There Anything Wrong With Hostile Tender Offers": Corporation Law Review Volume 6 No. 4 (1983) 329.

5. Shark Repellants: The Role and Impact of Antitakeover Charter Amendments. Study of the Office of the Chief Economist of the SEC, September 7, 1984. CCH Federal Securities Reporter 83,714.

6. Partial Takeovers - A Critique (1983) Company and Securities Law Journal Vol. 1 No. 5 251.

APPENDIX

The Returns to Offeree Shareholders in Partial and Full Takeover Offers

by

Peter Dodd
AGSM

APPENDIX

1. INTRODUCTION

This study has been prepared at the request of the Companies and Securities Law Review Committee (CSLRC). The objective is to empirically assess the effect of takeover bids on offeree company shareholders. In particular the study focuses on partial takeover offers and provides evidence on the investment returns earned by offeree shareholders in partial offers both in absolute terms and relative to those earned in full takeover offers.

The outline of the paper is as follows. The next section describes the data used in the study and section 3 discusses the methodology used to analyse that data. Section 4 presents the results and the final section discusses the implications and conclusions of the study.

2. THE DATA

Given the cost and time constraints imposed by the CSLRC, it was agreed at the outset that the study be limited to takeover offers in the two financial years 1981/82 and 1982/83. While there is no reason to believe this time period is in any way abnormal, it must be noted that 2 years is a relatively short sample period and generalisations based upon this sample data must be tempered accordingly.

The primary source of the data is the list of takeover offers collected and published by the Sydney Stock Exchange (SSE). This list appears to be the exhaustive set of offers made for companies listed on the SSE in the period July 1981 through June 1983. Restriction of the sample to firms listed in Sydney is not believed to impose any bias on the analysis. From this list and the company files at the SSE the following details of each offer were collected.

* Names of offeror and offeree companies
* Date of public announcement of the offer
* Number of shares sought in the offer
* Number of shares held prior to the offer
* Offer price
* Closing date of the offer
* Any revisions of the offer including price and closing date
* Outcome of the offer in terms of the number of offeree shares that were purchased in the offer.

Where these details could not be found in the SSE, they were collected from the company secretary of one of the firms involved.

The offers in the sample are classified as either full or partial offers. A full offer is defined in this study as an offer to acquire 100% of the outstanding shares of an offeree or target company. A partial offer is any offer for less than 100% of outstanding shares.

In a number of cases the initial offer is revised with a new offer price and closing date. For the purposes of this study, any such revision is treated as part of the initial offer and the duration of the offer is measured from the initial announcement through the final closing date of the ultimate offer made to shareholders. Similarly there are cases where a different offeror company makes a competing bid. Where the competing bid is announced before the closing date of the initial bid the duration of the offer is measured from the initial announcement through the closing date of the ultimate offer made to shareholders. The offer price is deemed to be that of the final offer.

To calculate the returns earned by shareholders, daily closing share prices have been collected from the Daily Official List of the SSE. Dividends and capital changes were collected from the files of the Centre for Research in Finance. Where an offeree company did not have traded prices around the relevant dates (see below) of the offer, it was not included in the analysis.[1] In cases where the offer price was in terms of shares in the offeror company, share prices were collected from the same source.

The descriptive details of the sample are summarised in Table 1.

1. Note that a company can be included in one part of the analysis but excluded from another when closing stock prices for that company are available at some relevant dates but not others. Hence the number of firms used in different parts of the analysis can vary.

3. THE METHODOLOGY

The essence of the methodology utilised in this study is to design the set of relevant investment strategies available to a rational shareholder facing a takeover offer. The returns to these strategies are then estimated and analysed.

The notion of alternative investment strategies is important. The mechanics of takeover offers are such that shareholders are faced with a process in which the uncertainty of the offer outcome is eliminated over a period of time. The process begins with the first public announcement of the offer. After this initial announcement there is uncertainty as to how the offer will conclude and a variety of outcomes are possible. For instance the bid can be revised and/or a competing offer emerge. On the other hand the offer may be withdrawn. In general, after the announcement of the offer, target shareholders are uncertain as to its final outcome. However, the existence of a well functioning stock market enables these shareholders to avoid the uncertainty of the offer outcome by selling in the market to investors willing to bear that uncertainty. In evaluating the returns earned by shareholders in takeover offers it is crucial to consider all the relevant investment strategies including selling shares in the stock market during the offer. Furthermore, it is essential to consider the different outcomes that are possible. For example, inclusion of only successful offers invokes a sample selection bias that seriously restricts the valid inferences that can be drawn from the study.

Since there are numerous possible outcomes to any offer and since the period from initial announcement through final resolution can encompass several months, there are endless investment strategies that can be implemented. As is shown below, in this study the strategies are limited to a small set of consistent investment decisions focused on the initial announcement and final outcome resolution dates.

Where there are no competing offers or any revisions to the original offer, the broad strategies available to a target shareholder are to:

1. accept the offer and tender all shares at the closing date

2. sell all shares in the stock market after the initial announcement and before the closing date

3. hold the shares, i.e., neither accept the offer nor sell in the market.

Where there is a competing offer (i.e., an offer from a different bidder announced before the first offer has closed) or the initial offer is revised, the offer process is more complex. For the purposes of this study it is assumed that, from the offeree shareholder perspective, the effective closing date is the closing date of the highest offer that is not withdrawn. It is possible that some shareholders will accept an offer before its closing date and thereby forego the possibility of receiving a higher competing bid. This would not appear to be a rational strategy and is ignored in the analysis below.

The broad strategies and the alternative outcomes are diagrammed in Figure 1 and discussed in more detail below. To calculate the returns to the alternative investment strategies the following definitions are used:

P = offer price of the final offer

PB = share price before the first public announcement of the offer, defined as the closing price 20 days prior to the initial offer announcement[2]

PC = share price at the closing date

~ = shares acquired in the offer as a percentage of shares accepted, i.e., the prorata percentage when the bidder does not acquire all shares tendered

PA = share price immediately after the initial offer announcement

d = dividend paid during the offer.

The specific investment strategies considered in this study are defined below.

2. The analysis below was replicated using a share price 40 days before the offer and while some differences were observed the general implications and conclusion are unchanged.

A. Full Takeover Offers

Strategy 1: Accept the offer and tender all shares to the bidder and

(a) all tendered shares are acquired in the offer.

The return to shareholders is defined as:

$$R = \frac{P - PB + d}{PB}$$

(b) all shares are returned by the bidder:

$$R = \frac{PC - PB + d}{PB}$$

Strategy 2: Sell in the market

(a) immediately after the offer is announced

$$R = \frac{PA - PB + d}{PB}$$

(b) at closing date

$$R = \frac{PC - PB + d}{PB}$$

B. Partial Takeover Offers

Strategy 3: accept the offer, tender all shares and

(a) all tendered shares are acquired in the offer:

$$R = \frac{P-PB+d}{PB}$$

(b) bidder prorates the offer and a proportion of tendered shares are acquired in the offer and the reminder are returned:

$$R = \frac{[\sim- P + (1-\sim)-PC] - PB+d}{PB}$$

(c) all shares are returned by the bidder:

$$R = \frac{PC - PB + d}{PB}$$

Strategy 4: Sell in the market

(a) immediately after the offer is announced:

$$R = \frac{PA - PB + d}{PB}$$

(b) at closing date

$$R = \frac{PC - PB + d}{PB}$$

Strategy 5: the offer is not accepted, all shares are retained and the offeror proceeds to acquire shares tendered by other shareholders i.e., the offeree shareholder foregoes opportunity to sell shares to offeror.

$$R = \frac{PC - PB + d}{PB}$$

4. RESULTS

The results of the analysis are presented in Table 2 which shows the returns to investors following the different strategies outlined above and in Table 3 which present the premiums by sub periods.

In terms of the more general strategies, shareholders accepting all full takeover offers and tendering their shares to the offeror earned average returns of 38.3 percent. Shareholders following the same strategy in partial offers earned average returns of 27.3 percent. As can be seen in Table 2 the returns earned vary across the different outcomes (the outcomes are defined by the prorata score which indicates the proportion of shares purchased by the offeror).

Assuming the samples of full and partial takeovers are independent, the difference between the average return to accepting a full offer and the average return to accepting a partial offer is not statistically significant (t statistic of 1.3).

Where an offeree shareholder followed the strategy of selling shares in the stock market after the initial announcement of the offer (and thereby avoiding the uncertainty of the offer outcome), the average return was 20.6 percent in full offers and 17.0 percent in partial offers and again the difference is not statistically significant.

While it is true that the lowest returns (mean of 7.5 percent) are earned by shareholders in partial offers where the offeror prorates the acceptance and returns some shares, this is only one possible outcome of the partial offers.

When all the possible outcomes are considered it seems that offeree shareholders in partial offers are not differentiated. In only a very few cases are offeree shareholders worse off after the offer than before.

Furthermore, when the returns from the various strategies are compared to those earned by investors in the stock market in general, it is clear that offeree shareholders do remarkably well. This analysis is presented in Table 2 as the Mean Market Adjusted Return. It is calculated by comparing the return to each strategy with the return earned on the market as a whole (taken from the files of the Centre for Research in Finance) over the duration of each offer. As can be seen in Table 2 offeree shareholders substantially outperform the market in all strategies for both full and partial offers.

5. CONCLUSION

This study presents evidence on the investment returns earned by offeree shareholders in takeover offers. The results indicate that on average, these shareholders make substantial gains from both full and partial offers. Furthermore, although the average return is generally smaller in partial offers than full, the difference is slight and not statistically significant.

Appendix

TABLE 1

Summary Description of the Sample of Takeover Offers

Announcement Date	Full	Partial
7/1981-6/82	68	16
7/1982-6/83	50	10
Total	118	26
Mean Market Capitalisation:	24.3m	43.4m
No. of Competing bids	15	
No. of Revised bids	28	
Consideration offered:		
cash	125	
stock	19	

TABLE 2

RETURNS TO OFFEREE SHAREHOLDERS IN TAKEOVERS

	No. of Firms	Mean No. of days in Strategy	Returns					Mean Market Adjusted Return
			Mean	Median	High	Low	% + ve	
FULL OFFERS								
Strategy 1: Accept offer								
(a) prorata = 1.0	70	92	40.2	36.3	157.9	-42.9	94.3	39.1
(b) prorata = 0.0	8	90	19.9	11.1	57.1	-13.3	75.0	18.0
Total	92	38.3						36.9
Strategy 2: Sell								
(a) at announcement	66	20	20.6	18.3	104.0	-33.3	86.4	20.4
(b) at closing	55	88	32.5	25.0	152.6	-26.7	87.5	29.3
PARTIAL OFFERS								
Strategy 3: Accept offer								
(a) prorata = 1.0	5	86	32.8	16.3	87.3	12.1	100.0	40.6
(b) 0 < prorata < 1.0	6	77	7.5	12.8	24.6	-3.9	67.0	12.0
(c) prorata = 0	10	88	36.4	43.2	112.5	-4.8	90.0	30.9
Total	21	84	27.3					27.8
Strategy 4: Sell								
(a) at announcement	18	20	17.0	11.7	125.0	-13.1	94.4	17.4
(b) at closing	19	86	18.1	10.6	112.5	-28.0	73.7	17.4
Strategy 5: Hold and prorata □ 0	9	84	-2.2	0.0	36.4	-28.0	55.5	2.5

TABLE 3

Premiums in Partial Bids

Period	Mean %	Std. Deviation	No.
July - Dec 81	16.8	7.0	4
Jan - Jun 82	31.9	29.1	8
July - Dec 82	23.7	10.2	5
Jan - Jun 83	30.3	19.7	4
Overall	26.8	20.4	21

CLICK ON HERE TO VIEW IMAGES

APPENDIX 2

LIST OF RESPONDENTS

Australian Associated Stock Exchanges
Australian Mutual Provident Society
Australian Shareholders' Association
BT Australia Limited
Burns Philp & Company Limited
Business Council of Australia
Capel Court Corporation Ltd. and Blake & Riggal
CSR Limited
Edwards Dunlop and Company Limited
Edward Lumley Ltd.
The Institute of Chartered Secretaries and Administrators
The Institute of Directors in Australia
James Hardie Industries Limited
Mr. S. Hannes
Kern Corporation Ltd.
Law Council of Australia: Business Law Section
Lloyds International Limited
London Stock Exchange: Settlement Services Division: Australian Office
Mathers Shoes Pty. Ltd.
Mayne Nickless Limited
Mr. F. E. Peters
Mr. N. E. Renton
The Federal Treasury

APPENDIX 3

RECOMMENDATIONS

RECOMMENDATION 1

The Committee recommends that:

* Partial bids be confined to proportional bids;

* Bidders be prohibited from including maximum acceptance conditions in the bid;

* Bidders be entitled, at their discretion, to confine the offer to persons registered as members of the offeree company at the offer date.

RECOMMENDATION 2

That CASA be amended to provide that:

(a) Where an offer is made to a shareholder who, in his acceptance, states that he is a trustee or nominee who holds a single parcel of shares in such a way that distinct parts of the whole are held for the account or benefit of different persons, that offer shall be deemed to constitute a separate offer in respect of each part and to be capable of acceptance by that shareholder accordingly; and (b) It shall be an offence for a shareholder to make in an acceptance a statement of the kind mentioned in paragraph (a) which is false.

RECOMMENDATION 3

That a person be prohibited from making a partial bid if by reason of the making of the bid or any acquisition of shares under it, the bidder or any associate would incur any obligation to make a payment or provide any other consideration under any pre-existing escalation agreement.

RECOMMENDATION 4

That the minimum price requirement formula set out in CASA s17(6)(7), and which at present applies only to takeover announcements, be applied also to takeover offers where the consideration consists wholly of cash or contains a wholly cash alternative.

RECOMMENDATION 5

That the Ministerial Council not disallow such alterations of the Listing Rules of Stock Exchanges as may be adopted in furtherance of the following principles:

(1) The constituent documents of a listed company may forbid the registration of share transfers resulting from a partial bid where the acquisition contemplated by the bid has not received shareholder approval in accordance with the following requirements;

(a) The approval required shall be the approval of such proportion (not exceeding a simple majority according to the number of shares held) as the constituent documents prescribe of those shareholders who vote pursuant to the adopted procedure.

(b) The bidder and its associates shall not be entitled to vote in these proceedings.

(c) The procedures for seeking approval shall be undertaken by the target company itself and may be by way of resolution at a general meeting or by ballot conducted independently of a meeting.

(d) The procedures must be completed and the result announced through the home exchange within a reasonable time before the closing date of the partial bid.

(2) Any proposal to insert in the constituent documents of a listed company a provision of the kind referred to in paragraph (1) must be accompanied by materials which:

* Explain the reasons for the proposed article and the factors and principles supporting or serving as a foundation for the reasons stated;

* State whether the proposal is the result of management knowledge of a specific attempt to take over the company;

* Describe the overall effect of the amendment;

* Discuss its advantages and disadvantages for both management and shareholders.

(3) Any such provision in the constituent documents of a listed company shall not continue in force for more than three years after its adoption, but may be renewed in the same manner as applies to its adoption.