

Takeovers issues – Treasury scoping paper

Background

The takeovers provisions in Australia aim to fulfil the Eggleston Principles. The Eggleston Principles are that, in any control transaction:

- the acquisition of control should take place in an efficient, competitive and informed market (efficient, competitive and informed market principle);
- the bidder's identity should be known to shareholders and directors of the target company (the revelation of identity principle);
- shareholders and directors of the target should have a reasonable time to consider the bid (the reasonable time principle);
- the bidder should give sufficient information to the shareholders to enable them to form a judgement on the merits of the bid (the disclosure principle); and
- each shareholder should have an equal opportunity to participate in the benefits offered under a bid (the equal opportunity principle).

The takeovers provisions have been largely successful in achieving these goals since their introduction. Market participants continue to make frequent use of takeovers and schemes of arrangement to effect control transactions. While the current framework has been largely successful, it is important to ensure that the law continues to operate effectively in response to market developments. The Australian Securities and Investments Commission (ASIC) has highlighted a number of areas where it is concerned that the current laws may need modernising.

Creeping acquisitions

The takeover provisions allow a shareholder with at least a 19 per cent stake in a company to acquire an additional three per cent in each six-month period, commonly known as a 'creeping' acquisition. As ASIC has highlighted, there is a potential for a shareholder to use this method to acquire a controlling stake without making a formal takeover bid.

A creeping acquisition may potentially allow an acquirer to avoid paying a takeover premium, or to pay a smaller premium. If there is no formal takeover bid, shareholders in the target company may not have an equal opportunity to participate in the transaction and receive any premium that is paid.

If the acquirer does not make a formal bid or acquire control in another permitted fashion (for example, via a scheme of arrangement or other transaction approved by target shareholders), the market may be uncertain as to the details of the proposed acquisition, such as the stake the acquirer ultimately intends to take and what they intend to do when they have control of the company's assets. This makes it difficult for the target company board to assess the acquisition and make recommendations to shareholders.

However, the three per cent allowance may contribute to an efficient capital market by facilitating capital raising and otherwise ensuring liquidity in a company, as it allows holders of large stakes in a company to trade in that company's shares.

Use and disclosure of equity derivatives

The current substantial holding provisions require disclosure if a person has a relevant interest in voting shares representing at least five per cent of a listed company. However, some equity derivative arrangements fall outside the scope of the current provisions as they may technically not give rise to a relevant interest.

Equity derivatives may be used to build up an undisclosed stake in a company in the lead up to a formal takeover bid. This may allow a bidder to offer a lower premium than would be required for a successful bid if the bidder did not already have the derivative stake.

Derivatives may also be used to acquire blocking stakes without this being disclosed. A related concern is that the writer of a derivative contract may hold the securities as a hedge against the contract, and that this holding has some potential to frustrate a takeover bid by a third party.

On the other hand, restricting the acquisition or requiring disclosure of derivative interests could increase costs for market participants, and may impact market participants who do not intend to take a controlling stake.

Clarity of takeovers proposals

Where a person publicly proposes to make a takeover bid, section 631 of the Corporations Act makes it an offence if that person does not proceed to make offers under that bid within two months of the proposal. The intention is to ensure that announced takeovers are followed through and offers are actually made.

There is a potential for would-be bidders to approach target boards with proposals that are structured in such a way that they do not enliven the requirement to make offers within two months.

Such proposals may be incomplete, conditional or ambiguous. Proposals to enter into a Scheme of Arrangement do not enliven section 631.

One concern is that non-genuine proposals of this nature might be used for rumour-mongering or market manipulation purposes, with implications for market integrity.

Another concern is that either the would-be acquirer or the target may leak the proposal as a way of applying inappropriate pressure on the other party.

Association

When determining a person's voting power (for example, for the purposes of the 20 per cent takeovers prohibition or the substantial holding disclosure requirements), the person's shareholdings are aggregated with the holdings of any associates.

Accurate disclosure of associations is therefore central to ensuring that the market for control is properly informed and that persons do not seek to obtain control through undisclosed associations.

In practice, undisclosed associations can be difficult to prove because the evidence for such associations will often be circumstantial. This may undermine the effectiveness of the association provisions. Because of this, in certain circumstances, shareholders who individually hold less than 20 per cent of a listed company may be able to improperly act together to exert undue control over the company without launching a takeover bid.

Impact of new media

With the rise of social and other new media, there are an increasing number of channels through which potentially price-sensitive information is disseminated. ASIC is working with the Australian Securities Exchange to provide listed entities with better guidance on how to respond to market rumours originating from outside conventional news or market channels. This may include guidance on the situations where it is appropriate to seek a trading halt until more complete or corrective disclosure can be made.