Legal Committee
of the
Companies and Securities Advisory Committee

Anomalies in the Takeovers Provisions of the Corporations Law

Report

March 1994

Contents

Introduction

Preparation of Report

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

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

Advisory Committee

The members are:

Mark Burrows (Convenor) - Baring Brothers Burrows & Co Limited
John Barner - Coles Myer Ltd
Reg Barrett - Westpac Banking Corporation
Professor Philip Brown - University of Western Australia
Alan Cameron - Australian Securities Commission
David Crawford - KPMG Peat Marwick
Leigh Hall - AMP Society
Wayne Lonergan - Coopers & Lybrand
Ann McCallum - Garraway & Partners
Alan McGregor - FH Faulding & Co Ltd
Mark Rayner - CRA Ltd
John Story - Corrs Chambers Westgarth
Charles Williams.

Legal Committee

The members at the time of settlement of the Report were:

Reg Barrett (Convenor) - Westpac Banking Corporation
Tim Bednall - Allen Allen & Hemsley
Tom Bostock - Mallesons Stephen Jaques
Ian Briggs - Philip & Mitaros
James Douglas QC - Barrister, Queensland
Colin Galbraith - Arthur Robinson & Hedderwicks
Geoff Hone - Blake Dawson Waldron
Marie McDonald - Blake Dawson Waldron
Valentine Smith - Dobson Mitchell & Allport

Malcolm Starr - International Banks and Securities Association of Australia.

Two persons who retired as members before the Report was settled were:

Rod Halstead - Clayton Utz
Barbara Whittle - Clayton Utz.

Four additional members have since been appointed:

Tony Abbott - Piper Alderman
Brett Heading - McCullough Robertson
Laurie Shervington - Minter Ellison Northmore Hale
Gary Watts - Fisher Jeffries.

Advisory Committee Executive

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

Background to the Report

In January 1993, the Legal Committee released for public comment a Discussion Paper (DP) on anomalies in the takeover provisions of the Corporations Law. The Committee sought submissions on the matters in the DP and any other anomalies encountered in the operation of Ch 6 (Acquisition of Shares) and related provisions in Pt 1.2 (Interpretation). Fourteen submissions were received.

This Report constitutes the first general review of the takeover laws since the Companies (Acquisition of Shares) Act and Codes (CASA) were enacted by the Commonwealth and the States in 1980. Aspects of CASA were reviewed by the Companies and Securities Law Review Committee in its *Report on the Takeover Threshold* (November 1984) and *Report on Partial Takeover Bids* (August 1985).

This Report contains 47 recommendations for reform. The recommendations seek to simplify the takeover provisions without disturbing their philosophical basis or requiring extensive legislative amendment.

Several recommendations take the form of draft amendments to the Corporations Law. The Legal Committee does not generally consider legislative drafting to be one of its functions. However, some recommendations are more usefully stated as draft amendments.

The Legal Committee thanks Vincent Jewell and John Kluver of the Advisory Committee Executive for their assistance in preparing the Report.

Overview of the Report

Structure

Part 1 examines several problems that arise from the concepts of power to vote and dispose, `relevant interest' and `entitlement', as used in the Corporations Law Pt 1.2 and Pt 6.1 to describe control over shares. In particular, it examines the difficulties in the operation of those provisions which trace a company's power over shares to persons who hold significant shareholdings in that company. The possible anomalous consequences of converting non-voting shares into voting shares are also considered.

In Part 2, the Legal Committee discusses anomalies in the exceptions in the Corporations Law Pt 6.2 to the prohibition on acquisition of shares in s 615.

Part 3 deals with procedural matters concerning the conduct of takeover bids under the Corporations Law Pts 6.3, 6.4 and 6.5. These include the formal requirements for offers, timing, offer conditions and controls on collateral benefits.

Part 4 considers deficiencies in the ASC's discretionary powers under the Corporations Law Pt 6.9 to modify the takeovers provisions.

Part 5 examines miscellaneous issues and Part 6 lists several policy issues for possible future review.

Appendix 1 contains a list of persons and organizations who responded to the DP. Appendix 2 summarizes the amendments to the Corporations Law and the Corporations Regulations recommended in the Report.

The Report does not consider the compulsory acquisition provisions in Pt 6.5 Div 6. These are the subject of a separate Issues Paper.

Unless otherwise indicated, all references in the Report are to sections of the Corporations Law.

Key recommendations

The Report's key recommendations include:

- overcoming technical deficiencies in the drafting and application of the concepts of relevant interest and entitlement[1]
- ensuring that the money-lending exemption covers all financing arrangements and extends to receivers and other persons acting in a similar capacity on behalf of money-lenders[2]
- preventing avoidance of the takeover rules through the acquisition of non-voting shares and their later conversion to voting shares[3]

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1 Recommendations 1 to 5.

2 Recommendation 7.

3 Recommendation 8.

- ensuring the 3% `creep' rule works properly where the issued share capital is altered in the relevant six month period[4]
- permitting shareholders of public as well as private companies to waive the takeover rules by unanimous consent[5]
- providing an alternative disposal procedure for *pari passu* allotments to foreign shareholders[6]
- repealing the general exemption for acquisitions pursuant to a prospectus[7]
- clarifying the rights of vendors and purchasers to agree to transfer large parcels of shares with the approval of shareholders or the ASC[8]
- giving shareholders the right to exempt a wider range of transactions from the takeovers laws[9]
- liberalizing the rules for exempting acquisitions in downstream companies[10]
- clarifying the time for determining shareholdings and the identity of shareholders at the outset of a bid[11]
- permitting an offer to be adjusted for differences in the amount unpaid on offeree shares[12]
- overcoming problems where accepting shareholders do not provide necessary documents of title[13]
- permitting registration and service of a Part A statement on the same day[14]
- clarifying the date for determining the need for an independent expert's report[15]
- reforming the rules governing permissible conditions[16]
- giving a bidder up to three days after close of the offer to determine the status of prescribed occurrence conditions[17]
- referring to `trading days' instead of `months' in the various time requirements for Part C announcements[18]
- reforming the rules governing the giving of discriminatory benefits[19]

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4 Recommendation 9.
5 Recommendation 10.
6 Recommendation 11.
7 Recommendation 13.
8 Recommendations 14 and 16.
9 Recommendations 15 and 16.
10 Recommendations 19, 20 and 21.
11 Recommendations 22, 23 and 24.
12 Recommendation 25.
13 Recommendation 28.
14 Recommendation 29.
15 Recommendation 30.
16 Recommendation 32 and 33.
17 Recommendation 34 and 35.
18 Recommendation 37.

- permitting simultaneous offers for different classes of securities[20]
- enhancing the ASC's discretionary powers to administer the takeover provisions.[21]

Matters referred to the Simplification Task Force

The Report identifies some matters which might appropriately be considered by the Simplification Task Force established by the Attorney-General in 1993 to simplify the Corporations Law. It suggests that the Task Force review the concepts of `relevant interest' and `entitlement' in the takeover provisions.[22] It also recommends that the Task Force review references to time periods in the Corporations Law.[23]

Policy issues for further review

Part 6 identifies policy issues, going beyond takeover anomalies, that may be the subject of further review.[24] These issues are:

- the possible misuse of the money-lending exemption
- disclosure in substantial shareholding notices of some interests that are currently disregarded
- requiring an offer to be extended where the offer price is increased in the last week of the offer period
- the financial details an offeror should disclose
- when an independent expert's report should be required.

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19 Recommendation 38, 39 and 41.
20 Recommendation 40.
21 Recommendation 44 and 45.
22 See pp 3 and 7.
23 See p 57.
24 See p 58.

Part 1. Concepts of control: power, relevant interests and entitlements

Inconsistency between ss 33 and 615

Chapter 6 regulates acquisitions of corporate control. It uses a shareholding of 20% as the threshold of regulation. However, the ASC has noted an inconsistency in applying this threshold where a person holds exactly 20% of a company's shares.[1] Paragraph 615(1)(a) forbids a person from becoming entitled to `*more than*' a 20% shareholding in a company unless the takeover rules in Chapter 6 have been followed. However, the effect of s 33 is that a person who becomes entitled to exactly 20% of the shares in an `upstream' company will breach s 615 where the upstream company is entitled to more than 20% of the shares in any `downstream' company unless the Chapter 6 takeover rules have been followed.[2] The ASC suggested that this anomaly could be overcome by bringing s 33 into line with s 615 by substituting the words `more than the prescribed percentage' for the words `not less than the prescribed percentage' in s 33. The Legal Committee agrees.

Recommendation 1: The words `more than the prescribed percentage' should be substituted for the words `not less than the prescribed percentage' in s 33.

Addition of the words `or an associate of the body corporate' in s 33

The associate reference. Two of the fundamental concepts in the takeover provisions are `relevant interest' in shares (Pt 1.2 Div 5) and `entitlement' to shares (s 609). The concept of relevant interest is concerned with a person's capacity to exercise some degree of power or control over the voting or disposal of particular shares. Entitlement covers these shares and any shares over which that person may have indirect power or control through an associate. Section 33 (one of the relevant interest provisions) attributes to a significant shareholder[3] in a body corporate the relevant interest that the body corporate has in any shares it holds. However, s 33 also attributes to the significant shareholder the relevant interest of `an associate of the body corporate', even where the significant shareholder has no direct influence over the associate. This extension to associates has anomalous effects.[4]

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1 ASC *Submission*.

2 Section 33 attributes power over shares in a downstream company held by an upstream body corporate to a person who has power to vote in respect of shares that constitute `*not less than*' the 20% of the upstream body corporate.

3 This Report uses the term `significant shareholder' to mean a person who holds not less than the prescribed percentage (20%) of shares in the company (s 33).

4 For example, assume that a body corporate A has an associate B which holds a relevant interest in 20% of the shares in company C. A and B are associates because they have entered into an agreement under which A is to acquire half of B's shares in C (s 12((1)(f)). Assume that a person P has power to vote in respect of 20% of the shares in A. This can be represented diagrammatically as follows:

The DP noted that the reference to an `associate of the body corporate' at the beginning of s 33 was not found in CASA s 9(5), the predecessor to s 33.[5] The Legal Committee understood that this additional reference was introduced to ensure that the relevant interest that a significant shareholder in one company has in another company's shares includes the relevant interests that any director of the significant shareholder's company has in that other company.[6] However, the Committee

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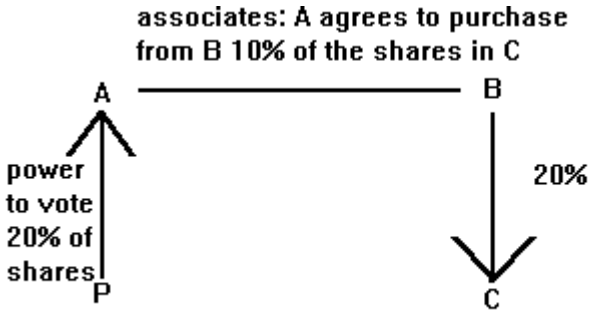


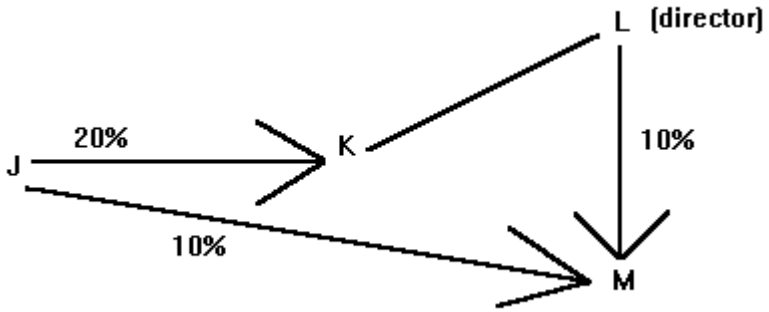
Section 33 provides that where an associate (B) of a body corporate (A) has power to vote or dispose of shares (in C), a person (P) shall be deemed to have in relation to the shares in C the same power as the body corporate (A) *or the associate* (B) has if the person (P) has power to vote in respect of not less than the prescribed percentage (20%) of the voting shares in the body corporate (A). Thus, under s 33, P is deemed to have B's relevant interest in 20% of the shares in C.

By contrast, A only has an interest in 10% of the shares in C (that is, the shares to which the agreement between A and B relates). A has a relevant interest in those shares under s 30(2), (3), as A will have power to vote and dispose of the shares when its agreement with B has been performed and thus immediately has that interest under s 34.

The current law therefore gives the more remote party, P, a greater percentage deemed relevant interest in C (20%) than the percentage relevant interest in C of the more proximate party, A (10%).

5 Section 33 traces to a significant shareholder (referred to in the section as `the person') the power that a body corporate *or an associate of the body corporate* can exercise in relation to shares. CASA s 9(5), the predecessor of s 33, only traced to the significant shareholder the power of the body corporate itself, not the power of an associate of the body corporate. The Explanatory Memorandum to the Corporations Bill 1988 acknowledged (without explanation) that s 33 extended CASA s 9(5) (para 272-3).

6 For example, company J holds 20% of the shares in company K. J is therefore a significant shareholder in K. L, a director of K, holds 10% of the shares in company M. J also holds 10% of the shares in M. J and L between them control 20% of the votes in M. This can be represented diagrammatically as follows:



The effect of s 33, as presently drafted, would be automatically to deem J (the significant shareholder) to have a relevant interest in the 10% shareholding of L (the director of the significant shareholder's company) in M.

considered that the significant shareholder should only have an entitlement to those shares where the significant shareholder and the director are associates under Pt 1.2 Div 2 or a relevant interest in the shares where they have an agreement, arrangement or understanding in relation to the shares. This is achieved without the additional reference to associates in s 33.[7]

The Committee took the view that the creation of artificially broad relevant interests by s 33 constitutes an unwarranted impediment to commercial transactions. In its current form, the section may even afford scope for the avoidance of Chapter 6 in some circumstances.[8]

Proposal and submissions. The DP proposed that the words `or an associate of a body corporate' should be removed from the introductory words of s 33 and the words `or associate' should be removed from the part of the section between s 33(b) and (c).[9] Submissions supported the proposal.[10] However, the ASC argued that the proposal would not overcome all the anomalies involving ss 33 and 609.[11] The Legal Committee considers that the Simplification Task Force should undertake a comprehensive review of relevant interests and entitlements. However, for the present, the Legal Committee strongly recommends that s 33 be amended as proposed in the DP.

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7 Take the facts of footnote 6 and assume that J and L are acting in concert with respect to each other's shares in M. J and L will be `associates' under s 15(1)(a). J would then be entitled to all the shares held by L in M (s 609). If J and L have an agreement, arrangement or understanding in relation to L's shares in M, for example one under which J may control the way L votes or disposes of its shares in M, J will have a relevant interest in those shares (ss 30(2), (3), 31).

8 For example, take the facts of footnote 6 and assume that L's shares in M have been acquired before L becomes a director of K and thus an associate of K. Upon L becoming a director, and thereby an associate, of K, s 33 immediately gives J a relevant interest in, and therefore an entitlement to, the shares held by L. J can then purchase any of those shares held by L in M without breaching s 615 (which refers to increases in entitlement), even where L holds more than 20% of the shares in M. A contravention of the Corporations Law would occur only if there was an impermissible flow-on increase in some other person's entitlement to shares in M.

9 Proposal 1. The effect of removing the additional references to associate from s 33 can be demonstrated through the facts of footnote 4. P's deemed interest in C will be traced only through A, not through A's associate, B. On the assumption that A has a relevant interest in the 10% of the shares in C that A has agreed to purchase from B, as explained in footnote 4, P, as a 20% shareholder in A, will have an equivalent relevant interest under the reformed s 33 (excluding the reference to `associate of a body corporate'). Thus, under the recommended reform of s 33, P's percentage deemed interest in C would be 10%, the same as the percentage interest of A. By contrast, under the existing s 33, as explained in footnote 4, P has a deemed 20% relevant interest in C through B, A's associate, notwithstanding that A has only a 10% relevant interest in C. It is logical that P, the more remote party, should have no greater deemed interest in C than A, the more proximate party.

10 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*, Prof Little *Submission*.

11 The ASC *Submission* stated that the Legal Committee proposal `does not solve the conflict between the scope and nature of relevant interests arising by virtue of the operation of section 33 (specifically, paragraphs (d), (e) and (f)) and the scope and nature of entitlements arising by virtue of the operation of section 609 (specifically paragraph 609(1)(b))'.

Recommendation 2: The words `or an associate of a body corporate' should be removed from the introductory words of s 33 and the words `or associate' should be removed from the part of the section between s 33(b) and (c).

Use of the phrase `(other than this section)' in s 33

In 1985, the predecessor of s 33 was amended by adding the words `(other than this section)'. The amendment was intended to prevent the provision having an over-reaching effect in consequence of deeming control through a chain of minority shareholdings.[12] A commentator suggested that the amendment did not achieve this result.[13] A proposed solution was that the words `(other than this section)' be moved to follow the word `Division' between s 33(b) and (c). The Legal Committee did not consider this to be a complete remedy.[14] Instead, the DP proposed that successive

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12 Before the amendment, the CASA equivalent of ss 32 and 33 was s 9(4). The amendment split the provision into two subsections. The new s 9(5) contained the tracing power that relied on holdings of more than the prescribed percentage of shares in a company. The Explanatory Memorandum to the Bill that contained the amendment said that `Unlike CASA s-sec. 9(4), proposed s-sec. 9(5) will not have an extended operation, ie. a person will not be deemed to have control of Company B if he controls 20% of Company A which controls 20% of Company B even though Company A is deemed to have control of Company B'.

13 Renard & Santamaria, *Takeovers and Reconstructions in Australia* (Butterworths, 1990-93) at [416]. This can be illustrated by the following example:

A Ltd --> 20% --> B Ltd --> 49% --> C Ltd --> 100% --> D Ltd

Assume that C is the body corporate first referred to in s 33 and A is the person referred to between paragraphs (b) and (c) of s 33.

C has power to vote and dispose of 100% of the shares in D, as required by s 33(a) and (b). This power arises directly and not by a deeming provision of the Division. Thus the words `(other than this section)' do not apply.

A has the same power as C has over the 100% shareholding in D for the reasons outlined in the following steps.

(i) A has power to vote in relation to not less than 20% of B which has power to vote in relation to 49% of C.

(ii) A is deemed by s 33 to have power to vote in relation to B's 49% shareholding in C.

(iii) Section 33 says that A (the `person') shall be deemed to have the same power to vote and dispose that C (the `body corporate') has if A has the power to vote in respect of not less than the prescribed percentage (20%) of the voting shares in C (s 33(c)).

(iv) A is deemed by the previous application of s 33 described in step (ii) to have, for the purposes of Pt 1.2 Div 5 (which includes s 33), the power to control not less than 20% of the shares of C as required by step (iii).

(v) A therefore has C's power in relation to 100% of the shares in D and s 33 has a successive effect notwithstanding the words `(other than this section)' which appear in the wrong place for the purpose of the example described.

14 Assume the same facts as in footnote 13, and apply s 33 from the perspective of B being the `body corporate' and A being the `person'.

(i) B is deemed by s 33 to have power to control the voting and disposal of C's 100% holding in D because B has 49% of the shares in C, which is more than the prescribed percentage (20%).

tracing through minority shareholdings could be avoided by leaving the words `(other than this section)' where they appear in s 33 and repeating them after the word `Division' between s 33(b) and (c).[15]

Submissions generally supported the proposal.[16] The Law Council agreed that an amendment to s 33 was necessary but its members differed as to the best approach. It put forward a number of alternatives, including to support the Legal Committee's proposal or to add a new subsection to prevent the successive effect. The Legal Committee does not consider that any alternative drafting suggested in the Law Council's submission is preferable to the proposal in the DP.

Recommendation 3: The words `(other than this section)' should be repeated after the word `Division' appearing between s 33(b) and (c).[17]

Sections 32 and 33 and the exceptions in s 38 to s 43

Exceptions deficient. Sections 38 to 43 seek to ensure that persons who hold shares in various capacities (for instance, voluntary proxies or bare trustees) or in consequence of certain transactions (for instance, some money-lending arrangements) are not regarded as controlling those shares. However, the protection afforded by these provisions may be undermined by the deeming effect of ss 32 and 33 for the following reasons.

- Sections 38 to 43 focus on characteristics of the person whose relevant interest is to be disregarded but fail to deal with the characteristics of another person through whom a consequential relevant interest is derived.[18]

(ii) If the words `(other than this section)' are moved from the opening words of s 33 as suggested, this power of B can be taken into account in giving further effect to s 33.

(iii) Under s 33, A (the `person') shall be deemed to have the same power as B (the `body corporate') has or is deemed to have in relation to the 100% shareholding of C in D because A has the power to control not less than 20% of the voting shares of B.

(iv) A's power over the shares in B would be disregarded if it were a power that is deemed to arise under s 33. However, the power of A over 20% of the shares in B is real and does not depend on the previous application of s 33.

(v) Therefore deleting the words `(other than this section)' from where they currently appear in s 33 would continue to permit s 33 to have a successive effect.

15 Proposal 2.

16 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*, Prof Little *Submission*.

17 Assume the same facts as in footnote 13. Having the words `(other than this section)' in both places will mean that neither of the problems described in footnotes 13 and 14 will arise. Inserting the words after `Division' will prevent A from having the power to vote in respect of not less than the prescribed percentage (20%) of the voting shares in C for the purposes of s 33(c) (step (iii) of the example in footnote 13). Keeping the words where they currently appear will prevent A from being deemed to have B's power in relation to the shareholding of C in D (steps (i) and (iii) of the example in footnote 14) as B's power is deemed by a previous operation of s 33.

- Sections 32 and 33 are expressed in terms of powers to vote and dispose, rather than relevant interests. The instruction in s 38 to s 43 to ignore certain relevant interests is not expressed in terms consistent with ss 32 and 33.

Proposal in Discussion Paper. The DP proposed[19] that a new s 31(3) should be added to the Corporations Law to make it clear that

- a person's relevant interest will be disregarded if the relevant interest of the person through whom it was derived would be disregarded and
- in determining whether the provisions for disregarding relevant interests apply, a relevant interest should not be distinguished from the power to vote in respect of or dispose of a share that constitutes the relevant interest.

Submissions. The proposal was supported by submissions.[20] In regard to the second problem dealt with by the proposed subsection, the ASC pointed out that, on one interpretation, the term `relevant interest' might already cover the powers of voting and disposing of shares that it represents. However, the ASC agreed that the proposal should be adopted to overcome doubt.

Recommendation 4: A new s 31(3) should be added to the Corporations Law as follows:

> "Where a relevant interest of a person in a share is required by this Division to be disregarded, the power of the person to vote in respect of the share or the power to dispose of the share which gives the person that relevant interest in the share under subsection (1) or (2) shall be disregarded for the purpose of determining whether any person has a relevant interest in any shares.".

The words `for the purposes of this Division'

Sections 34 and 35 deem a person to have a relevant interest in certain circumstances `for the purposes of [Division 5 of Part 1.2]'. However, the deeming of a relevant interest under ss 34 and 35 should apply principally to Chapter 6. One submission queried whether the language of ss 34 and 35 permitted this and proposed that either

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18 For example, company A (not a money-lender) has power to vote in respect of and dispose of more than 20% of company B's shares. B is a money-lender. Section 38 provides that B's relevant interest in any shares it holds as security is disregarded. By virtue of ss 31 and 33, A has a relevant interest in those security shares. That relevant interest is not disregarded under s 38 since A's ordinary business, unlike B's, does not include money-lending.

19 Proposal 3.

20 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*, Prof Little *Submission*.

- the expression `for the purposes of this Division' should be deleted from ss 34 and 35 or
- the words `and Chapter 6' should be inserted after `for the purposes of this Division' in ss 34 and 35.[21]

The Legal Committee considers that the definition of `relevant interest' in s 9 provides the necessary link between the meaning of relevant interest in Pt 1.2 Div 5 and in Chapter 6. However, the Legal Committee considers this indirect drafting approach unsatisfactory. The Committee recommends that this matter be part of the review of relevant interests and entitlement which it has recommended the Simplification Task Force undertake.[22]

The concept of entitlement in s 609 and the exceptions in s 38 to s 43

The DP identified two problems with s 609(2).

Exclusions and entitlements. First, there is an inconsistency between s 609(2) and the relevant interest provisions in Pt 1.2 Div 5. Subsection 609(2) provides that a person becomes entitled to shares by entering into certain agreements in relation to them. This entitlement arises notwithstanding the exclusions in s 38 to s 43. For instance, the relevant interest of a money-lender in shares held as security will be disregarded under s 38. However, the money-lender will also have a separate entitlement to those shares under s 609(2)(c) which is not disregarded. Similarly, the relevant interest held by a voluntary proxy over shares will be disregarded under s 41, but the proxy holder will have a separate entitlement to those shares under s 609(2)(a).

The DP proposed that s 609 be amended to provide that a person's entitlement under s 609(2) shall be disregarded if the matters that give rise to the entitlement also give the person a relevant interest that would be disregarded under the relevant provisions of Pt 1.2 Div 5.[23]

Nominees. The second problem the DP identified is that s 609(2) may deem certified nominee bodies corporate to have an entitlement to shares of their associates, contrary to the apparent purpose of s 609(1)(b).[24]

The DP proposed that s 609(2) be amended to ensure that certified nominee bodies corporate are not taken to be entitled to shares of their associates.[25]

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21 Rosenblum *Submission*.

22 See p 3.

23 Proposal 4.

24 Paragraph 609(1)(b) provides that a person is entitled to the shares of any associates of that person (unless the association only arises by virtue of s 12(1)(d), (f) or (g)) but makes an exception if the person is a nominee body corporate approved by the ASC. However, a similar exception is not found in s 609(2). Thus an approved nominee body corporate may have an entitlement under s 609(2) where it has a relevant agreement in relation to shares. There was no similar problem under CASA s 7(3)(b), as there was no equivalent of s 609(2).

Submissions. Both proposals were supported.[26] However, the ASC suggested going further by repealing s 609(2) outright.[27] The Legal Committee agrees for the reasons given below.

Repeal of s 609(2). This subsection was originally introduced to ensure that a person who is an associate of another only by virtue of an agreement relating to particular shares has an interest in those shares only, not all shares held by the associate.[28] The Legal Committee agrees with this policy, but considers that provisions of the Corporations Law other than s 609(2) largely achieve it.[29] The repeal of s 609(2) would have the consequence that a person who had entered into an agreement under which the person could `influence substantially' the exercise of voting power attached to shares[30] would not, on that criterion alone, have an entitlement to those shares. This would change the existing law. The Legal Committee considers, however, that the concept of substantial influence over the exercise of voting power is too vague and remote to be an appropriate test for entitlement to shares.

Repeal of s 609(2) would also remove possible practical problems in its interpretation. It is arguable that s 609(2) results in a proposing offeror being entitled to all the target company shares held by offerees when the offeror serves the Part A statement.[31] On this interpretation, the offeror could then acquire all the offerees' shares *in any way* without contravening s 615(1), subject to the obligations of the offeror under the takeover scheme and to any declaration by the Corporations and Securities Panel. However, the offeror could not exercise the compulsory acquisition powers under s 701.[32]

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25 Proposal 5.

26 ASC *Submission*, Corrs *Submission*, Prof Little *Submission*.

27 ASC *Submission*. ASC Policy Statement 69 para 6 indicates that the Commission will normally grant relief from s 609(2) in relation to the circumstances in s 38 to s 43.

28 Paragraph 609(1)(b) provides that a person is entitled to shares in which its associate has a relevant interest, but excludes associates by virtue of s 12(1)(d), (f) and (g) which relate to agreements with respect to shares. Subsection 609(2) then gives a person an entitlement to shares where the person has entered into an agreement in relation to the shares in circumstances corresponding with those described in s 12(1)(d), (f) and (g). This ensures that the entitlement is only to the shares which are the subject of the agreement, not all the shares held by the person who is an associate under s 12(1)(d), (f) and (g).

29 Namely the relevant interest provisions in ss 30 (in particular, s 30(2) and (4)), 31 and 34. The second paragraph after the diagram in footnote 4 shows how facts that are likely to produce an entitlement under s 609(2) also produce a relevant interest under these provisions.

30 s 609(2)(a)(iii). This test also appears in the associate provisions: s 12(1)(d)(iii).

31 This follows from the language of s 609(2)(b)(i): the proposing offeror is `a person' who `proposes to enter into an agreement with another person ... under which the first-mentioned person [the proposing offeror] will *or may* acquire ... shares in which the other person [the offeree] has a relevant interest' so that `whatever other effect the agreement may have, the first-mentioned person [the proposing offeror] is entitled to those shares'. The provision has no exceptions which might preclude this result. By contrast, s 16(1)(c) provides that a person is not to be taken to be an associate of another person merely because `one has sent, or proposes to send, to the other a takeover offer ... within the meaning of Chapter 6, in relation to shares held by the other'.

32 A notice under s 701(2) of compulsory acquisition of shares for which a takeover offer has been made applies only to `outstanding shares'. Outstanding shares are `shares subject to acquisition' (other than shares acquired by the offeror otherwise than under the takeover scheme) in respect of which the offer has not been accepted (s 701(1)(c)). The definition of `shares subject to

Recommendation 5: The Corporations Law s 609(1)(c) and (2) should be repealed and s 609(1)(b) should be retained in its current form.

Nominee bodies corporate

Paragraph 609(1)(b) and s 609(3) refer to `a nominee body corporate', a term which is not defined. On the other hand, the expression `nominee corporation' is defined in s 9 but not used elsewhere in the Corporations Law or the Corporations Regulations. The predecessor provisions CASA s 7(3)(b) and 7(8) referred to `nominee corporation', defined in the Companies Code s 5(1). That expression appears to have been changed to `nominee body corporate' in s 609 without a corresponding change in the definition.[33]

Recommendation 6: The definition of `nominee corporation' in s 9 should be changed to a definition of `nominee body corporate'.

Exceptions for money-lenders: ss 38 and 630

Exemption too narrow. The Corporations Law recognizes that money-lenders may take security over shares in the ordinary course of their business. Section 38 provides for relevant interests which arise from taking such security to be disregarded. Also, s 630 exempts from s 615 acquisitions by money-lenders resulting from enforcement of a security over shares. However, these provisions relate only to `a transaction ... in connection with lending money'. This concept may be too narrow to accommodate other financing arrangements, such as the granting of bill facilities.[34]

Proposal and submissions. The DP proposed that ss 38 and 630 be broadened beyond lending money to any provision of financial accommodation.[35] Submissions supported the proposal.[36] The ASC, however, queried whether the term `financial accommodation' was sufficiently clear. It proposed instead that the exemption be expressed in terms of the obligation to pay or repay money owing (but not restricted to obligations arising under a loan agreement). The Legal Committee considers that the ASC's suggested wording would not be any clearer than `provision of financial accommodation' and may in fact be interpreted too narrowly. A reference to `financial

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acquisition' excludes shares to which the offeror was entitled when the first of the offers was made (s 701(1)(a)).

33 Renard & Santamaria, supra, footnote 13 at [401] Antn 20.

34 A separate policy issue is whether the money-lending exemption, however drafted, may provide an opportunity to avoid the takeover provisions: see Part 6 of this Report, **Further Policy Issues**.

35 Proposal 6.

36 Corrs *Submission*, AARF *Submission*.

accommodation' would have the advantage of simplicity and would permit the courts to give a commercially realistic interpretation to ss 38 and 630.

Receivers. One submission raised the possibility that a receiver appointed by a money-lender may not have the protection of s 38 or s 630.[37] It proposed that these exemptions from s 615 include receivers and other persons acting in a similar capacity. To remove any possible doubt, the Legal Committee considers that the legislation should specifically exempt these persons.

Syndicates of lenders. One submission[38] argued that it is uncertain whether s 38 would cover a member of a syndicate of lenders who purchases the rights of a fellow member. The Legal Committee considers that lenders in a syndicate should be able to adjust their rights between themselves. The Committee considers, however, that the reference to `a security given ... in connection with lending money' is sufficient to cover any adjustment of rights between members of a syndicate.

Recommendation 7: Sections 38 and 630 should be made more comprehensive by substituting words to the effect of `provision of financial accommodation by any means' for the term `lending money' and by extending the provisions to include a receiver appointed by a money-lender or any other person acting in a similar capacity.

Exclusion of certain trustees: s 39

Under s 39(a), a relevant interest in a share subject to a trust is disregarded if the interest is held by a trustee and `a beneficiary under the trust is by section 34 deemed to have a relevant interest in the share because the beneficiary has a presently enforceable and unconditional right referred to in paragraph 34(b)'. One submission pointed out a difference between this language and that in s 34(b).[39] The Legal Committee notes, however, that the latter provision performs a different function. It brings forward the time at which a person is taken to have a relevant interest where the person `has a right enforceable against another person in relation to an issued share in which the other person has a relevant interest, whether the right is enforceable presently or in the future and whether or not on the fulfilment of a condition'. The Legal Committee does not regard this difference in language as anomalous and does not consider that an amendment to s 39(a) is necessary.

Conversion from non-voting to voting shares

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37 Corrs *Submission*.

38 Prof Little *Submission*.

39 Sly & Weigall *Submission*.

Loophole. Section 615 provides that a person `shall not acquire shares in a company' if any person would `immediately after the acquisition' be entitled to more than the prescribed percentage (20%) of the voting shares in the company. A loophole exists where shares that are convertible from non-voting to voting are acquired and the rights of conversion are not immediately exercised. The loophole arises where a person

- acquires sufficient convertible shares to entitle the person to more than the prescribed percentage (20%) of voting shares when the conversion rights are later exercised but
- exercises the conversion rights when sufficient time has elapsed to prevent the increase in entitlement to voting shares being regarded as occurring `immediately after the acquisition'.

The effect of s 31(2) is that the convertible shares are `acquired' within the meaning of s 51(1) when they are first purchased.[40] At that stage s 615 does not apply as the shares are non-voting. If and when those shares are subsequently converted into voting shares, no further acquisition takes place. The prohibition in s 615 does not apply as the increase in entitlement is not `immediately after the acquisition'. The DP proposed that the definition of `acquire' in s 51 be amended so that a person also `acquires' shares for the purpose of Chapter 6 when non-voting shares convert to voting shares.[41]

Submissions. Submissions generally supported the proposal in principle.[42] The Committee's recommendation in this Report draws upon drafting suggestions made in submissions.[43] The Committee also intends that its proposed amendment cover converting preference shares.[44]

One submission expressed concern about the proposal.[45] It queried how convertible non-voting shares issued before any legislative amendment might be treated. It noted that transitional provisions may be necessary to protect shareholders who may have acquired these securities on the basis that there was no legal bar to conversion. The Legal Committee does not support transitional provisions, which would create two `classes' of convertible shares. Moreover, existing holders of convertible shares could, if necessary, seek an exemption from the ASC. The submission further noted that in some cases partly paid shares confer no voting entitlement until they are fully paid. The Committee agrees that in those circumstances, the full payment of partly paid shares would be treated as an acquisition under its recommendation. It considers this

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40 Subsection 31(2) provides that a person who has power to dispose of a share, whether voting or non-voting, has a `relevant interest' in the share. A person who purchases convertible preference shares obtains power to dispose of them and therefore `acquires' a relevant interest as defined in s 31(2). Paragraph 51(1)(a) deems a person to have acquired shares when that person acquires a relevant interest in those shares as a result of a transaction.

41 Proposal 7.

42 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*.

43 ASC *Submission*, Rosenblum *Submission*.

44 This type of share automatically becomes an ordinary voting share at a fixed future time. This occurs without any active 'conversion' by the holder of the shares or the issuing company.

45 Mr Levy of Freehill Hollingdale & Page *Submission*.

result appropriate. Any increase in voting entitlement should be subject to s 615 unless it falls within one of the exceptions. Finally, the submission raised the possibility that non-voting shares might be converted to voting shares by amendment to the constituent documents of a company. The Committee considers that such an event should also be caught by the new provision.

Recommendation 8: A new subsection should be added to s 51 as follows:

> "A person who comes to have power to vote in respect of a share (other than a power to vote in relation to any or all of the circumstances mentioned in the definition of a voting share in section 9) shall be taken to acquire the share, notwithstanding that the person already had power to dispose of the share.".

Part 2. The exceptions to the s 615 prohibition[46]

Creeping acquisitions: s 618

Different arithmetical concepts

Failure to achieve policy. The policy of s 618 is to allow a person to increase an entitlement by 3% in any six month period even though the acquisition would give that person or another person an entitlement to more than 20% of the voting shares in the company. Section 618 achieves this result where there is no change in a company's issued share capital in the relevant six month period. However, the section creates anomalies where there is a change in the company's issued share capital during the six month period. Where share capital is increased, the provision does not permit a person's entitlement to increase by the full 3%.[47] Conversely, where share capital is reduced, a person's entitlement may lawfully increase under s 618 by more than 3%.[48]

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46 Some of the discussion of policy issues in relation to the exceptions to the s 615 prohibition draws on an unpublished dissertation for the degree of Master of Laws at the University of Sydney by Vincent Jewell.

47 For example, A holds 50 000 shares in company B which has an issued share capital of 100 000 shares. A subscribes for an additional 3 000 shares (3% of the original share capital). The value of VA1 (number of voting shares to be acquired) in the formula in s 618 is 3 000 and the value of V (total number of voting shares) is 100 000. Assuming that no shares have previously been acquired and none have been disposed of, the value of VA2 (number of voting shares acquired in the previous six months) is zero and the value of VD (number of voting shares disposed of in the previous six months) is also zero. Therefore

$$\frac{100\ (VA1 + VA2 - VD)}{V} = \frac{100\ (3\ 000 + 0 - 0)}{100\ 000} = 3$$

that is, it does not exceed 3 and is therefore within s 618. A is then entitled to 53 000 of the 103 000 shares in B. This only represents approximately 51.456% of the increased share capital. Now that the share capital has increased, A will be able to subscribe for 90 more shares (that is, VA1 will be 90), because the value of V is now 103 000 and the value of VA2 is 3 000 so that

$$\frac{100\ (VA1 + VA2 - VD)}{V} = \frac{100(90 + 3\ 000 - 0)}{103\ 000} = 3.$$

A is then entitled to 53 090 of the 103 090 shares in B: this shareholding represents approximately 51.499% of the shares in B. Successive subscriptions by A will relate to fewer and fewer shares in B and A's shareholding will not approach the 53% of the shares to which A should be entitled in accordance with the policy of s 618.

48 For example, A holds 25 000 shares in company B which has an issued share capital of 100 000 shares. A's entitlement is 25%. Four fifths of the shares in B are cancelled in a proportional reduction of capital. A now holds 5 000 shares of a total issued share capital of 20 000 shares. A's entitlement is still 25%.
However, A is free under s 618 to acquire the remaining 15 000 shares in B. The number of A's shares disposed of (VD in the formula in s 618) is 20 000, the same as the total number of shares on issue (V in the formula). The value of VA1 will be 15 000, the value of VA2 will be zero. Therefore

$$100\ (VA1 + VA2 - VD) \qquad 100\ (15\ 000 + 0 - 20\ 000)$$

The anomalies arise from basing the section on numbers of shares rather than percentage entitlement.[49]

Proposal and submissions. The DP proposed that s 618(1) and (2) be redrafted to refer to percentage entitlement rather than the number of shares to which a person is entitled.[50] Most submissions supported this proposal.[51] The ASX, however, disagreed with the proposal as it affects underwriters and sub-underwriters. The ASX pointed out that any shares lawfully acquired by an underwriter or sub-underwriter under the current s 621 are nevertheless taken into account in calculating the number of shares acquired in a six month period for the purpose of s 618.[52] This limits the underwriter's or sub-underwriter's ability to acquire other shares under s 618. The DP proposal would permit underwriters and sub-underwriters to increase their entitlement by a further 3% in addition to shares acquired as part of their underwriting. The Legal Committee considers this appropriate. The underwriting exemption is a separate concession. There seems no reason why shares acquired under this separate exemption should count in the 3% calculation. The Committee further recommends that shares acquired by an underwriter pursuant to s 622(3) (acquisitions pursuant to an underwriting agreement disclosed in a prospectus) should also be disregarded in counting the 3% of shares that can be acquired pursuant to s 618.

Recommendation 9: Section 618 should be amended so that it is based on percentage entitlements rather than number of shares acquired. It should permit an acquisition of voting shares provided that, after the acquisition, the percentage entitlement of any person to voting shares is not greater than 3% more than the sum of

(cont.)

$$\frac{\text{V}}{\text{20 000}} = \frac{\text{}}{\text{}} < 3.$$

49 The mismatch between the s 615 prohibition (expressed in terms of percentage entitlement) and the exception in s 618 (expressed in terms of the number of voting shares acquired and disposed of and the total number of voting shares in the company) has been recognised in the Corporations Law in one respect. Section 618 excludes shares acquired pursuant to a pari passu allotment from the number of shares to be taken into account in calculating the 3% of shares that may be acquired.

50 Proposal 8.

51 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*.

52 Currently, in counting the shares that may be acquired in addition to the 3% creep shares, the s 618(2) definition of `VA2' excludes shares acquired by the person by a pari passu allotment

- in relation to which s 621(1) applies and
- made as a result of the person's acceptance of an offer made in accordance with s 621(2)(b).

Such acquisitions constitute only one type of acquisition permitted by s 621 (s 621(1)(b)(i)). The others are where the allotment is made to a person as underwriter to the allotment (s 621(1)(b)(ii)) or to a person as nominee in accordance with s 621(3) which deals with overseas shareholders (s 621(1)(b)(iii)). The latter two types of acquisition are not excluded when counting the 3% of shares that s 618 permits to be acquired. Relevant interests acquired by nominees under s 621(3) would be disregarded under s 39(b) (the exemption for bare trustees).

- the person's percentage entitlement six months before the acquisition and
- any increase in percentage entitlement that came about because the person took up entitlements under a pari passu allotment under s 621 or as an underwriter or sub-underwriter under s 622(3).

To achieve this, s 618(1) and (2) should be replaced by a single subsection:

> "Section 615 does not prohibit an acquisition of voting shares in a company because of the effect of the acquisition on a person's entitlement to voting shares in the company if:
>
> (a) the person has been entitled to not less than the prescribed percentage of the voting shares in the company for a continuous period of not less than 6 months ending on the day immediately before the day on which the acquisition takes place; and
>
> (b) the acquisition does not result in the percentage entitlement of the person to voting shares in the company increasing to a figure greater than the sum of:
>
> (i) the person's percentage entitlement to voting shares in the company at a date six months before the date of the acquisition;
>
> (ii) any increase in the person's percentage entitlement to voting shares in the company which has taken place during that period of six months by an acquisition to which section 621 or subsection 622(3) applies; and
>
> (iii) 3%.".

Existing s 618(3) should be retained.

Downstream acquisitions

Listed upstream companies. The DP pointed out that s 618 does not permit the acquisition of shares in one company (the upstream company) if there is any consequential increase of entitlement in another company (the downstream company) that would breach s 615.[53] The DP proposed to overcome this prohibition for listed upstream companies by an amendment to s 629. This is recommended elsewhere in the Report.[54]

Unlisted upstream companies. The DP also proposed that any acquisition in a downstream listed or unlisted company consequent upon an acquisition under s 618 in an upstream unlisted company should be permitted.[55] Two submissions argued

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53 For example, where A holds 19% of the shares in company B and B holds 25% of the shares in company C, s 618 does not permit A to acquire another 3% of the shares in B. This is because A would, by virtue of s 33, breach s 615 in relation to C by increasing its entitlement from 0% to 25% of the shares in C.

54 Recommendation 19.

55 Proposal 9.

strongly against this proposal.[56] One objected to any exemption where the downstream company is listed.[57] It was concerned that a person could take effective control of a listed company by achieving control of its upstream unlisted holding company through creeping acquisitions under s 618. The ASC objected to any exemption where the upstream company is unlisted, whether or not the downstream company is listed. The Commission argued that, where an upstream company is listed, `the market in the shares in the downstream company will be fully informed before any change of control [in that company] occurs'. This may not happen where an upstream company is unlisted. The Legal Committee agrees with these objections and no longer considers that s 618 should be amended to permit 3% acquisitions in unlisted upstream companies regardless of their downstream effect.

Acquisitions in small companies or with the consent of the shareholders: s 619

Unanimous consent. Section 619 provides that acquisitions of shares do not breach s 615 where

- the company in which the shares are being acquired has 15 or fewer members or
- the company is a proprietary company and all the members consent in writing.

The second exception allows members of a proprietary company, of whatever size, to make an informed decision to waive Chapter 6 in respect of a particular acquisition. The DP argued that the principle of unanimous shareholder consent should not be confined to proprietary companies. It proposed that members of a public company may also, by unanimous consent, exclude Chapter 6 in respect of an acquisition.[58]

Submissions. Submissions supported this proposal.[59] The ASC pointed out that the Explanatory Memorandum to the Companies (Acquisition of Shares) Bill said that CASA s 13(1)(a) and (b), the predecessors of s 619, were intended to permit acquisitions of shares otherwise prohibited by CASA s 11 (s 615) `where the company involved may be regarded as not being owned by the public or a section of the public'. The ASC suggested that it was therefore `unnecessary and arbitrary to maintain the distinction between proprietary and public companies, because a public company with more than 15 members may have a sufficiently accessible and close membership to provide a suitable basis for the application of this exception'. Another submission noted that the proposal would have no real application to larger companies.[60] The Legal Committee agrees and considers that the requirement of

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56 ASC *Submission*, Sly & Weigall *Submission*. Only one, Corrs *Submission*, favoured the proposal.

57 Sly & Weigall *Submission*.

58 Proposal 10.

59 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*.

60 AARF *Submission*.

unanimity will mean that the exception will generally only apply to small public companies.

The Law Council suggested that any general disclosure requirements in s 623 also be included in s 619. The Legal Committee agrees.

Recommendation 10: The words `is a proprietary company and' should be deleted from s 619(1)(b). The provision should also explicitly require that shareholders be given all such information as they would require to make an informed decision whether or not to approve the acquisition.

Renounceable rights issues: s 621(2)(b)

The Law Council has raised doubts whether s 621(2)(b) would exempt from s 615 renounceable as well as non-renounceable pari passu rights issues. The Legal Committee does not consider that an offer that meets the description in s 621 will fall outside that exemption merely because it is capable of being assigned. The offer to shareholders is within the terms of s 621(2)(b), whether or not the rights issue is renounceable. However, the exemption does not extend to acquisitions by assignees of these renounceable securities. The Legal Committee considers it appropriate that the exemption is confined in this way. No amendment is therefore necessary.

Pari passu allotment to foreign shareholders: s 621(3)

Subsection 621(3) stipulates the procedure for a pari passu allotment of shares to qualify for the exemption in s 621 where it is not proposed that shares be offered directly to foreign shareholders of the relevant company.[61] Subsection 621(3) provides that, in lieu of making offers to the foreign shareholders, the company may allot the appropriate number of shares to an approved nominee who then arranges for the disposal of those shares for the benefit of the foreign shareholders.

That procedure is out of step with ASX Listing Rule 3E(11) and current practice whereby the nominee or trustee in a renounceable issue does not subscribe for the shares but merely disposes of the rights to acquire the shares and then distributes any proceeds to the foreign shareholders in accordance with their entitlements. The subscription procedure in s 621(3) is not popular because it could lead to the nominee suffering a loss where the issue price of the shares is pitched close to the market price. The DP proposed that s 621 be brought into line with ASX Listing Rule 3E(11) and current practice.[62] Submissions supported this proposal.[63]

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61 This will usually happen because of the disproportionate cost of complying with applicable foreign securities laws (most notably those of the United States of America) having regard to the number of foreign shareholders.

62 Proposal 11.

Recommendation 11: Section 621 should be amended to permit a nominee of foreign shareholders to sell pari passu rights, with the proceeds to be paid to the foreign shareholders in proportion to their shareholdings. This procedure should be an alternative to that in s 621(3).

Extending s 621 to pari passu issues of options

One submission[64] raised the problem of a shareholder presently entitled to more than 20% of the shares in a company seeking to exercise its rights pursuant to a pro rata issue of options or other convertible securities. Section 621 does not permit acquisitions pursuant to exercise of these rights. Section 618 applies to such acquisitions, though the number of shares that may be acquired under this provision will depend on how many other shareholders have previously exercised their rights, and when they did so.[65]

The submission suggested that this problem might be overcome by extending s 621 to cover options or other convertible rights issued pari passu. The Legal Committee considers that, in principle, the policy underlying s 621 should apply to all pari passu

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63 ASC *Submission*, Corrs *Submission*, ASX *Submission*.

64 Mr Watson of Sly & Weigall *Submission*.

65 Section 618 does not necessarily permit a shareholder to exercise all the options to which it is entitled. If other shareholders have already exercised their rights, the shareholder's percentage entitlement will reduce. When it exercises its rights, it will increase its entitlement, possibly beyond the 3% permitted by s 618. For example, A holds 30 000 shares in company X which has an issued share capital of 100 000 shares, that is, A holds 30% of the issued share capital of X. Seven other shareholders, B, C, D, E, F, G and H each hold 10 000 shares, or 10% of the issued share capital, in X. A pari passu allotment of options to take up one new share for each four existing shares is made. The options are valid for five years and exercisable during two `window' periods in each year during the five year term of the option. B, C, D, E, F, G and H exercise their options at the end of the second year but A does not exercise its options then. At the end of the second year, B, C, D, E, F, G and H each hold 12 500 shares in X. The total share capital of X is:

shares held by A	30 000
shares held by B, C, D, E, F, G and H	87 500
TOTAL	117 500.

A's shareholding now represents about 25.5% of the issued share capital of X. At the end of four years, A wants to exercise its options. This would entitle it to a further 7 500 shares in X and raise the total number of shares in X to 125 000. A's total shareholding would be 37 500, which would restore it to holding 30% of the issued share capital of X. However, this represents an increase in entitlement of about 4.5%, which falls outside the increase of 3% which would be permitted by s 618. Recommendation 9 in this Report, relating to s 618, deals with the failure of the current s 618 to deal with increases in the capital base, but only where the other requirements for s 618 are fulfilled, in particular that acquisitions must have taken place within a six month period. In addition to a shareholder's inability to regain its previous entitlement under s 618, it would be unable to determine how many options it might exercise under this provision unless it is aware how many other options have already been exercised.

rights issues, whether of options, other convertible rights or shares. In each instance, all shareholders have an equal opportunity to acquire further shares. However, there are situations where s 621 should not entitle the holders of such securities to exercise their rights, for instance, where a person has acquired options before moving to a holding of 19.9% of the voting shares in the company. Legislation to deal with each possible situation would inevitably be complex. The Legal Committee considers that a better alternative is for the ASC to prepare a Policy Statement setting out the circumstances in which it will modify s 621 to permit acquisitions pursuant to the exercise of such rights. The principles identified by the submission might be taken into account by the ASC in exercising its discretion.[66]

Recommendation 12: The ASC should prepare a Policy Statement setting out the circumstances in which it will permit a holder of options or securities convertible into shares to exercise its rights notwithstanding a consequential increase in entitlement that would otherwise breach the Corporations Law.

Acquisitions pursuant to a prospectus: s 622(1)

Policy issues. Subsection 622(1) exempts from s 615 an acquisition of shares pursuant to an allotment or purchase arising from an invitation or offer in a lodged or registered prospectus.

It is unclear what policy justifies this exception. One commentator regards the exception as arising from the complementarity of the prospectus and takeover provisions.[67] He suggests that, just as a prospectus need not be issued where a takeover scheme is on foot,[68] so an acquisition of shares pursuant to a prospectus should be excluded from the takeover provisions. However, the Legal Committee notes that the policy goals of the prospectus and takeover provisions differ. The prospectus provisions are concerned only with disclosure whereas the takeover provisions serve further functions, in particular giving target company shareholders an equal opportunity to participate in benefits accruing from a person's acquisition of a substantial interest in the company.[69]

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66 Mr Watson of Sly & Weigall *Submission* said that `a person who receives options (or other rights to take up shares) in a pro-rata issue should be allowed to exercise the options so received at any time at least so long as the entitlement of that person at the time of the issue of the options concerned:

- plus any increase in that entitlement arising from any acquisition of shares (other than in consequence of the exercise of those options) permitted under Chapter 6; and
- less any decrease in entitlement to the extent that it results from sale or disposal of shares (but not an issue of new shares)

in each case occurring after the date of the issue of options, is not increased'.

67 N O'Bryan, `Takeover Offers and Prospectus Requirements under the Companies Code' (1985) 3 C&SLJ 3, 4.

68 Corporations Regulations reg 7.12.02.

69 s 731.

Even in relation to disclosure, the recipients of the information (whom the Corporations Law is intended to protect) are not the same for prospectuses and takeovers. The prospectus provisions are aimed at persons (whether or not existing members) who might acquire shares in the company. The takeover provisions are intended to assist current shareholders in deciding whether to accept the offer.

In this context, the Legal Committee notes two other exceptions from s 615 for acquisitions of shares

- by promoters through an allotment made in accordance with a first prospectus (s 622(2)) and
- as a result of allotments made by companies that have not started any business or exercised any borrowing power (s 624).

These exceptions are appropriate since the takeover legislation is concerned with acquisitions made after a company has been operating, not acquisitions referable to the time when the company first solicited subscription, or prior to its commencement of business.[70] In the Legal Committee's view, these two exceptions cover the circumstances where a prospectus exemption is justified.

Consequence of s 622(1). Another anomalous result of the exemption in s 622(1) is that it renders s 621 superfluous, given that the Corporations Law, unlike its predecessor, requires a prospectus for a rights issue. Once a prospectus has been issued, shares can be allotted without the need for the directors to follow the procedure set out in s 621 for a pari passu allotment.

Consequence of repealing s 622(1). The repeal of s 622(1) would not unduly inhibit major shareholders from subscribing for shares pursuant to a prospectus. For instance, these shareholders may acquire the shares

- under the exemption in s 618
- under the exemption in s 621 for pari passu allotments (including the exemption for underwriters (see s 621(1)(b)(ii))
- by shareholder approval under s 623.

Major shareholders may also acquire shares as underwriters under s 622(3).

The DP proposed that s 622(1) be repealed.[71]

Submissions. Comments in the submissions supported this proposal.[72] The ASC said that:

> `While, in the case of an initial capital raising, there is no existing (public) membership whose interests need to be protected in accordance with section 732 principles, existing members in a floated company (where secondary sales and subsequent issues are concerned) have an interest in

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70 HAJ Ford & RP Austin, *Ford's Principles of Corporations Law* (6th edn, Butterworths, 1992) para 2022, p 731.

71 Proposal 12.

72 ASC *Submission*, Corrs *Submission*, AARF *Submission*, Law Council *Submission*.

> ensuring that any change in control of the company takes place in accordance with section 732 principles.'

The ASC also noted that the exception in s 622(1)

> `applies to a purchaser under a one-off secondary prospectus in the same way as to an allottee under a primary prospectus in relation to an offer to the public. The current secondary prospectus regime is not designed to ensure that existing members of a company which has already been floated are provided with sufficient information to enable them to assess their position in respect of a proposed change of control of the company or that they will have an equal opportunity to participate in any benefits accruing from a person acquiring a substantial interest in the company.'

The Legal Committee agrees with these observations.

Recommendation 13: Subsection 622(1) should be repealed.[73]

Acquisitions agreed to by shareholders: s 623

Permitting pre-meeting and other conditional agreements

The s 34 problem. Section 623 permits the members of a company in general meeting to agree to an acquisition which would otherwise contravene s 615. However, s 34(a) provides that a person is deemed to have a relevant interest in shares at the time of entry into an agreement to obtain that relevant interest. Similarly, s 34(b) deems a person to have a relevant interest in a share where the person has an enforceable right in relation to the share, whether the right is enforceable presently or in the future and whether or not on the fulfilment of a condition.

These provisions create difficulties where a vendor and purchaser agree to transfer shares subject to members' approval under s 623.[74] On one interpretation of s 34, the purchaser will be taken to have immediately acquired a relevant interest and hence breached s 615 before the meeting can be held. This view was taken by Cohen J in *Baden Pacific Ltd v Portreeve Pty Ltd*.[75]

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73 Section 622A, introduced by the Corporate Law Reform Act 1993, should also be repealed. This was foreshadowed in the Explanatory Memorandum to the Bill para 303: `Section 622 of the Law is presently under review by CASAC and the policy reflected both in section 622 and proposed section 622A may subsequently be altered'.

74 The difficulty does not arise for proposals to allot shares under a s 623 agreement, as s 34 only applies to currently issued shares: ASC Policy Statement 74 para 36.

75 (1988) 14 ACLR 677.

A more pragmatic interpretation was adopted by Perry J in *Magnacrete Ltd v Robert Douglas-Hill*.[76] His Honour ruled as follows.

- CASA s 9(6) (the predecessor of s 34) does not apply to an agreement which clearly contemplates that there will be no acquisition of shares until the passing of the members' resolution. The only contractual obligations which may properly be identified before the meeting are those which go to the obligation to hold the meeting.
- Alternatively, the words `on performance of the agreement' in s 34 must be read in the context of s 623 so that if the performance of the agreement is otherwise permitted by s 623, s 34 does not bring it within the s 615 prohibition.

It is doubtful whether the view of Perry J is sustainable under the Corporations Law. His Honour concluded that CASA s 9(6) permitted an agreement in which shareholder approval of a proposed allotment or purchase was a condition precedent to the creation of any obligations concerning the shares. However, the definition in s 9 of `relevant agreement' as used in s 34 is wider than `agreement' as used in CASA s 9(6). `Relevant agreement' is defined as

> "an agreement, arrangement or understanding:
> (a) whether formal or informal or partly formal and partly informal;
> (b) whether written or oral or partly written and partly oral; and
> (c) whether or not having legal or equitable force and whether or not based on legal or equitable rights".

It is probable, at least on a strict interpretation, that an agreement subject to approval at a s 623 meeting, even where the approval is a condition precedent to the formation of the agreement, will amount to an `arrangement' or an `understanding' which is a relevant agreement under s 34 and will result in an immediate breach of s 615.[77] Such a result is clearly contrary to the policy underlying s 623. The DP proposed amendments to ss 34 and 609 to make them consistent with s 623.[78] It suggested that the following subsection be added to s 34:

> "Where performance of a provision in a relevant agreement or the enforcement of a right in respect of issued shares of a company would contravene section 615, subsection (1) does not apply to the extent that the provision or right is subject to a condition that the provision shall not come into effect or the right shall not be enforceable unless a resolution has been passed at a general meeting of the company pursuant to section 623.".

The DP also proposed a consequential amendment to s 609. This will not be necessary if Recommendation 5 (repeal of s 609(2)) is adopted.

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76 (1988) 15 ACLR 325. The reasoning in this case was approved by White J, with whom Mohr and Millhouse JJ agreed, in *Niord Pty Ltd v Adelaide Petroleum NL* (1990) 2 ACSR 347, 360.

77 An alternative view is that there must be an implied limitation to the scope of s 34 for s 623 to have a practical operation: ASC Policy Statement 74 para 42.

78 Proposal 13.

Submissions. The ASC stated that, in administering the legislation, it is prepared to interpret `relevant agreement' on a purposive basis to permit persons to agree to put a resolution to shareholders in accordance with s 623.[79] However, it supported the DP proposal to remove any uncertainty.

The ASX suggested that the legislation provide that the s 623 exemption not apply to any agreement where the condition for shareholder approval can be waived. The Legal Committee considers such a provision unnecessary, as waiver of the condition would take the agreement outside the exemption.

The Law Council noted that the s 34 problem affected provisions other than s 623. It suggested that the DP proposal be extended to any agreement that is subject to a condition precedent, the fulfilment of which would result in there being no breach of the takeover provisions. The Legal Committee agrees. The conditions could be

- obtaining the agreement of shareholders at a s 623 meeting
- obtaining consent of all members to an acquisition under s 619(1)(b)[80] or
- obtaining the approval of the ASC.

Contents of agreements. The Corporations Law does not stipulate what should be permitted in any pre-meeting or other conditional agreement concerning voting or disposal rights over shares.

Voting rights. The Legal Committee considers that an agreement should not permit a potential purchaser to exercise any power or control over the voting rights attached to the shares to be acquired.[81] To do so would allow that person to exercise effective control or influence over a company before the conditions of the agreement are met.

Disposal rights. The ASC requires that the vendor be `free to dispose' of the shares at any time before a s 623 resolution is passed.[82] The Legal Committee disagrees with this policy. It considers that restrictions on disposal should be permitted in s 623 and other conditional agreements, with the purchaser having injunctive and other remedies for breach.[83] Without these restrictions, the parties would have no commercial certainty about the transaction during the time between the agreement and the meeting of shareholders.

Time restriction. There should be a time limit on agreements which restrict the disposal of shares, to prevent indefinite controls over disposal. Those agreements should become void ab initio unless

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79 This approach is now set out in ASC Policy Statement 74 paras 43-48.

80 Law Council *Submission*.

81 This accords with the ASC view that the purchaser should not have any voting power over the shares to be acquired at any time before a s 623 resolution is passed: ASC Policy Statement 74 para 47(c).

82 ASC Policy Statement 74 para 47(b). Corrs *Submission* adopted the same approach. Presumably, freedom to dispose in this context means that the purchaser cannot obtain a remedy. If so, the Legal Committee queries whether that arrangement could be described as an `agreement', rather than merely a proposal to buy and sell shares.

83 Prof Little *Submission* adopted the same approach.

- shareholders agree at a s 623 meeting
- all members consent to an acquisition under s 619(1)(b) or
- the ASC approves

as the case may be, within three months of the date of the agreement.

Summary. A permitted conditional agreement

- does not give any power or control over voting rights
- may permit restrictions on disposal rights
- if the agreement restricts disposal rights, becomes void if the relevant approval or consent has not been obtained within three months.

Disregarding relevant interests. The controls on share acquisitions in s 615 could be circumvented if a potential purchaser obtains an immediate relevant interest in, and therefore an entitlement to, shares by entering into a permitted conditional agreement.[84] The Legal Committee recommends that a purchaser's relevant interest arising from entry into a permitted conditional agreement shall be disregarded until the conditions are met.

Wider problem. One submission[85] pointed out that the problem of a purchaser obtaining a relevant interest before the holding of a s 623 meeting arises generally under Pt 1.2 Div 5, not just under s 34.[86] The Legal Committee agrees. It considers that the provision permitting conditional agreements should apply to Pt 1.2 Div 5 generally, not just s 34.

Recommendation 14: A new provision should be added to Pt 1.2 Div 5 to permit an agreement that is conditional upon

- the passing of a resolution at a general meeting pursuant to s 623
- obtaining the consent of all the members of the company (s 619(1)(b)) or
- obtaining the approval of the ASC.

(cont.)

84 The purchaser under a permitted conditional agreement concerning certain shares might also enter into a subsequent agreement to acquire voting rights in those shares. The second agreement would not breach s 615 by increasing the purchaser's entitlement to the shares, as s 34(a) would already give the purchaser a relevant interest in, and thus an entitlement to, the shares under the first agreement.

85 Rosenblum *Submission*.

86 For example, a purchaser might obtain a relevant interest in shares under ss 30(4) and 31 by entering into an agreement.

The agreement may prohibit the vendor from disposing of the shares before the relevant approval or consent has been obtained, but must not give the purchaser any power or control over the voting rights attached to the shares. If the agreement restricts disposal of shares, it shall be void ab initio unless the relevant approval or consent has been obtained within three months of the date of the agreement. A purchaser's relevant interest arising from entry into a permitted conditional agreement should be disregarded until the relevant approval or consent has been obtained.[87]

Limitation of s 623 to acquisitions by allotment or purchase

The exemption in s 623 only applies to an acquisition of shares by an allotment or purchase.[88] It does not cover other arrangements constituting an acquisition of shares for the purpose of s 615, for example, an agreement giving control over the voting or disposal of shares.[89] The DP took the view that this restriction is unjustified. Shareholders should be permitted to agree to any form of acquisition of a specified maximum number of shares in their company by a particular person.[90]

Submissions generally agreed that the types of acquisition for which shareholder approval may be sought should be widened.[91] However, submissions raised two areas of concern.

- Should shareholders be permitted to approve an acquisition of options or other convertible securities exercisable well into the future? The ASC suggested that such approvals be allowed, but only for a maximum of 12 months. Approval could be renewed at an annual general meeting without undue expense. The Legal Committee considers that the concern about indefinite approvals is adequately dealt with by the requirement that the identity of the acquirer must be known by the approving shareholders. This would exclude shareholders from being asked to approve the future acquisition of transferable securities by a person whose identity was

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87 Recommendation 14 deals with the concern in the Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, *Corporate Practices and the Rights of Shareholders* (November 1991) para 3.3.50 that the law governing pre-meeting arrangements be made more certain.

88 The section can apply to an allotment of shares to be made on the exercise of an option or convertible security: ASC Policy Statement 74 para 58.

89 See Renard & Santamaria, supra, footnote 13 at [507].

90 Proposal 14. Section 623 has already been interpreted by the New South Wales Court of Appeal in *NCSC v Consolidated Gold Mining Areas NL (No 2)* (1985) 9 ACLR 768 to require the approval to be for a particular person to acquire a particular number of shares. The Court required that

- shareholders be informed of the identity of the person to whom the shares will be allotted, the number of shares to be allotted and the allottee's existing shareholding and
- there be before the general meeting a proposed allotment, not merely a proposal to enter into some other kind of transaction which might ultimately produce an allotment.

91 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, ASX *Submission*, AARF *Submission*, Sly & Weigall *Submission*, Prof Little *Submission*.

unknown at the time of the resolution.[92] In other circumstances, temporal limitations are unnecessary.

- Should s 623 contain greater disclosure requirements, either in general form or of specific identified matters in addition to the matters identified in the DP (identity of the acquirer and the maximum number of shares that may be acquired)? One submission argued that there should be detailed legislative prescription, in the same manner as for takeover documents, based on the ASC draft Policy Statement on s 623 (now ASC Policy Statement 74).[93] The ASX suggested that s 623 should require disclosure of every person who will acquire a relevant interest under the transaction, not just the parties to the transaction. The Legal Committee considers that the disclosure requirements in s 623 should be drafted in general terms with only minimum specific prescription, given the variety of possible acquisitions that shareholders may be asked to approve. It proposes that shareholders should be given all such information as they would require to make an informed decision whether or not to approve the acquisition. In some instances this may require disclosure of persons who will acquire a relevant interest. The Legal Committee prefers this test to the one proposed by the ASC, namely, sufficient information to enable shareholders to assess the merits of a proposed acquisition.[94] Further disclosure details are most appropriately set out in an ASC Policy Statement.[95]

Recommendation 15: Section 623 should be amended to remove all reference to allotment or purchase so that shareholders can approve any acquisition of shares.

Recommendation 16: Section 623 should explicitly require that

- any resolution approved by shareholders identify the person by whom the shares will be acquired under the agreement and the maximum number of shares that may be acquired
- shareholders should be given all such other information as they would require to make an informed decision whether or not to approve the acquisition.

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92 This would be consistent with ASC Policy Statement 74 (released after the ASC *Submission*) para 60 which states that `approval under s 623 will only have been given to the person named in the resolution. It will not have been given to any person to whom the options or convertible notes are transferred'.

93 Rosenblum *Submission*.

94 ASC *Submission*. See now ASC Policy Statement 74 para 5. A merits test may impose an obligation to evaluate, not simply disclose, information.

95 ASC Policy Statement 74 paras 8-33 sets out detailed disclosure requirements.

Acquisitions pursuant to compromise or arrangement: s 625

Section 625 exempts acquisitions pursuant to Pt 5.1 from the s 615 prohibition. The exemption of acquisitions of shares `under' a compromise or arrangement approved by the Court may not allow for all possible acquisitions which would fall within the policy of the provision. The term `under' may suggest some limitation on the application of the provision.[96] The DP proposed an amendment to deal with this possible limitation.[97] Submissions supported the proposal.[98] The Legal Committee notes the decision of Murray J in *Re Stockbridge Ltd*[99] which gives some support to the proposition that the word `under' may have sufficient width. However, to resolve any doubt, the Committee recommends that s 625 should also refer to an acquisition `by virtue of' a compromise or arrangement.

Recommendation 17: The words `or by virtue of' should be added after `under' in s 625.

Acquisitions by exercise of option or right: s 627

Section 627 provides that an acquisition of shares does not breach s 615 where

- it results from the exercise of a renounceable option or an option or right conferred by a convertible note and
- an acquisition of shares at the time of acquiring the renounceable option or convertible note would not have contravened s 615 because it would have been within the exemption for share market purchases in s 620.

The DP identified two possible shortcomings in this provision.

- There does not appear to be any policy reason for limiting s 627 to renounceable options and convertible notes.
- It is arguable that s 627 does not require the convertible securities to have been acquired in the ordinary course of stock market trading. On one reading of s 627, it is necessary only that the convertible securities be acquired at a time when s 620 would have permitted the acquirer to acquire shares.

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96 The implementation of a scheme of arrangement may involve an acquisition of shares in a company by a person who is not already a member (for example, by the creation of a new holding company). The acquisition may not be regarded as being `under' the scheme (which is between the company and its members only) although it is contemplated in, and necessary for the effective operation of, the scheme.

97 Proposal 15.

98 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*.

99 (1993) 9 ACSR 637.

The DP proposed that s 627 should apply to any convertible securities and that the requirement in s 620 that the shares be acquired in the ordinary course of stock market trading should also apply to the acquisition of convertible securities under s 627.[100] Submissions supported these proposals.[101] The ASC was concerned that the proposals were `intended to entirely replace the present reference to section 620'. The Committee does not propose that the reference to s 620 be replaced.

Recommendation 18: Section 627 should be amended to

- apply to any convertible securities, not just renounceable options and convertible notes
- provide that the convertible securities must have been acquired `at an official meeting of a stock exchange in the ordinary course of trading on the stock market of that stock exchange'.

Downstream acquisitions: s 629

Outline of s 629

Section 629 exempts from s 615 downstream acquisitions, that is, acquisitions of shares in one company (the downstream company) that result from the acquisition of shares in another company (the upstream company), if the following three conditions are met.

- The upstream company is listed on the Australian Stock Exchange (s 629(a)).
- The upstream company is incorporated in Australia (also s 629(a)).
- The acquisition of shares in the upstream company results from the acceptance of an offer to acquire those shares under a takeover scheme or a takeover announcement or an acquisition under s 620 made on-market while a takeover scheme or takeover announcement for the upstream company is on foot (s 629(b)).

CASA s 12(k), the predecessor of s 629, only required that the upstream company be listed on the Australian Stock Exchange, not that it also be incorporated in Australia. Also, s 12(k) had no equivalent of the third condition. The reasons for making the Corporations Law narrower than CASA in these two respects are obscure.

Need for exemption

The rationale for this type of exemption is that a downstream acquisition that is merely incidental to the main objective of acquiring the upstream company should not inhibit the upstream acquisition, especially where the upstream company is listed. Put

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100 Proposal 16.

101 ASC *Submission*, Corrs *Submission*, AARF *Submission*, Prof Little *Submission*.

another way, unless the upstream acquisition is a mere artifice, having as its true object the acquisition of the downstream company, the downstream acquisition should be exempt. Rather than articulate an exemption along these uncertain lines, the policy has been to provide a clear exemption where the upstream acquisition is in a listed company. In those circumstances, the upstream acquisition is likely to be a serious bid, involving the acquisition of a substantial company with a large number of shareholders, not an artifice to gain control of the downstream company. If the acquisition of a listed company were used as an artifice to acquire another company, the ASC could seek a declaration under s 733 that an unacceptable acquisition or unacceptable conduct had occurred.

Without the exemption for downstream acquisitions, companies could make themselves takeover-proof by holding strategic parcels of shares in a series of other companies.[102]

A further reason for exempting downstream acquisitions that result from takeovers of listed companies is that, while the offer price for the securities in the upstream listed company is set by the market, the price that the bidder for the upstream company should pay for the shares in the downstream company (the `see through' price) has to be determined by an inevitably unsatisfactory process of calculation or valuation[103] rather than by the market.

Elements of the exemption

(i) Characteristics of the upstream company

Downstream acquisitions are only permitted where an upstream company is

- listed on the ASX (whether or not also listed overseas) and
- incorporated in Australia.

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102 Clause 1966 of the Explanatory Memorandum to the Corporations Bill 1988 said that the downstream exemption `precludes the use of investments above the level prescribed in cl.615 as an undesirable defence tactic to a takeover of a listed company'. The possibility of using investments in this way can be illustrated by the following example. Company A holds 21% of the shares in each of companies B, C, D, E and F. If there were no exemption for downstream acquisitions, a person who wanted to take over A would also need to comply with Chapter 6 in relation to B, C, D, E and F.

103 Apart from the normal difficulties facing a valuer in determining a `fair value' of shares in a company (see *Hawker de Havilland Ltd v Australian Securities Commission* (1991) 6 ACSR 579, 591), there is the additional difficulty of deciding whether the price for the downstream shares should include any `control premium'. In *BTR plc v Westinghouse Brake & Signal Co (Aust) Ltd* (1992) 7 ACSR 122, Lockhart and Hill JJ considered that it would only `be reasonable to fix the price at which the takeover offers are to be made so as to confer upon the holders of shares in the underlying company, so far as possible, the same benefit as will be conferred upon the holders of the upstream company' if `the decision-maker determines that such a benefit will be given and that it reflects a control premium relative to the parcel of shares in the underlying company and the rights of control which attach to that parcel' (at p 138). Beaumont J considered that once the valuer had been asked for an opinion of the `fair and reasonable' value of the shares, it was a matter for the expert opinion of the valuer whether this value was or was not to include a `control premium' (at p 154).

Listing on the ASX. Both CASA and the Corporations Law require the upstream company to be listed in Australia. An exemption for listed companies is necessary to preserve the free market in their shares. There is not the same need in relation to unlisted companies.

The DP agreed with the prerequisite of listing but proposed that it be extended to listing on overseas securities exchanges specified in the regulations after consultation with the ASC.[104] In contrast, under the Corporations Law, the ASC individually considers exemptions for downstream acquisitions in relation to companies listed only overseas.[105] Various submissions agreed with the DP proposal,[106] although the ASX considered that the requirement for listing in Australia should be retained.

The ASC *Submission* argued that it should continue to have the discretion to consider individually proposed upstream acquisitions in overseas listed companies, to determine whether the consequential acquisition in a downstream Australian company is truly incidental to the upstream acquisition or is `a device to avoid making a full bid for the Australian company'.[107] The Legal Committee considers that effective participation by Australia in international capital markets requires greater certainty. Internationally recognized exchanges in key trading centres should be prescribed by regulation.[108] The ASC could have the power to declare foreign securities exchanges in addition to those prescribed. All Australian downstream acquisitions that result from upstream acquisitions in corporations which have one of those exchanges as their home exchange should be exempt from s 615.

The Legal Committee notes that prescribing overseas exchanges in regulations would remove the ASC's present discretion to impose conditions favouring downstream shareholders on bidders for upstream overseas companies listed on recognized exchanges.[109] However, downstream shareholders should be treated the same whether the upstream company is listed in Australia or on a recognized overseas exchange. In both instances, the ASC could apply to the Corporations and Securities Panel if there has been unacceptable conduct.[110]

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104 Proposal 17.

105 See ASC Policy Statement 71, which replaces NCSC Release 157. See also *Magellan Petroleum Australia Pty Ltd v ASC* (1993) 11 ACSR 306.

106 Corrs *Submission*, AARF *Submission*, Mr Murdoch *Submission*.

107 ASC Policy Statement 71 sets out the principles governing the exercise of the ASC's discretion.

108 The Legal Committee considers that the criteria used to determine approved exchanges should be those adopted by the ASC in Policy Statement 72 `Foreign Securities Prospectus Relief' para 24, namely whether the exchange

- is a member of the *Fédération Internationale des Bourses de Valeurs*
- is internationally recognized, as evidenced by concessional treatment and recognition granted by other jurisdictions
- has rules which meet the ASX's listing and quotation, market information, regulatory and trading and settlement principles
- is a key world trading centre and
- is overseen by a government regulatory authority.

Whether the laws regulating takeovers in the foreign jurisdiction are compatible with Australian takeovers legislation should not be a relevant criterion.

109 Adoption of the Legal Committee's view would render much of ASC Policy Statement 71 redundant.

110 s 733.

The ASC *Submission* also proposed that any exemption from listing in Australia be dependent upon an upstream acquisition complying with the rules of the approved foreign exchange and the laws of the jurisdiction of the foreign exchange. The Legal Committee disagrees. The ASC proposal may create considerable uncertainty about the application of the exemption to individual cases. Moreover, compliance is a matter for the authorities of the particular jurisdiction.

One submission disagreed with the width of the DP proposal.[111] It contended that shareholders in the downstream company should have the opportunity to share in that part of the control premium for the upstream company that effectively represents a premium for control of the downstream company.[112] The Legal Committee disagrees. The shareholders in the downstream company can ascertain the pattern of shareholding in their company. Where a large proportion of the shares is held by a listed company, investors will be aware that there is a real possibility that effective control of the downstream company may change. Moreover, it is of paramount importance that impediments should not be placed on the acquisition of shares in listed companies merely because they have significant shareholdings in other companies. This principle should apply equally to Australian and overseas listed companies.

Incorporation in Australia. The Corporations Law requires the upstream company to be incorporated in Australia. This was not required under CASA.

The original text of the Corporations Bill 1988, like CASA s 12(k), required only that the company be `included in the official list of a stock exchange', whether or not incorporated in Australia. The reason for including the additional Australian incorporation requirement in s 629 may have been the *Paringa* case in which the upstream company (Paringa) was listed but not incorporated in Australia (and hence not subject to CASA[113]), and not subject to regulation in its country of incorporation.[114] The primary problem with the Paringa takeover, however, was not the downstream consequences, but the fact that the takeover of the upstream company itself was not covered by any system of takeover regulation.

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111 Rosenblum *Submission*.

112 Rosenblum *Submission* suggested that the exemption for downstream acquisitions `should depend upon the proportion of the assets of the upstream company that are represented by the holding in the downstream company' and that a bidder for an upstream company should have to bid for a downstream company when the shares in the downstream company comprise more than a certain percentage, for example 30%, of the assets of the upstream company. Mr Murdoch *Submission* suggested a similar approach.

113 The takeover provisions of CASA and the Corporations Law Chapter 6 apply only to Australian incorporated companies: CASA s 6 definition of `company' and Companies Code s 5(1) definition of `company'; Corporations Law s 9 definition of `company'.

114 Paringa Mining & Exploration Co plc (Paringa, the `upstream company') held half the shares in North Flinders Mines. Paringa was listed in Australia. The downstream acquisition of shares in North Flinders Mines that resulted from the takeover of Paringa therefore fell within the CASA s 12(k) exception. However, as Paringa was incorporated in the United Kingdom, the acquisition of its shares was not regulated by CASA. Furthermore, as Paringa was domiciled in Australia, it was not subject to the City Code on Takeovers and Mergers in the United Kingdom. It was therefore not covered by any system of takeover regulation.

The DP considered the requirement of Australian incorporation in s 629 unduly restrictive, not justified on the basis of one isolated instance, and inconsistent with the proposal to include upstream companies listed on approved overseas exchanges. It proposed that the requirement be removed and the CASA approach be restored.[115] Several submissions agreed.[116]

To solve the problem arising from the *Paringa* case, the DP also asked whether s 53A should be widened to permit the ASC to declare a company incorporated overseas but having sufficient nexus with Australia to be a Chapter 6 company and therefore subject to its provisions.[117] The ASC *Submission* suggested that it was unlikely that Australian law would ever have complete jurisdiction in respect of upstream foreign companies, but suggested several cases in which there may be sufficient nexus.[118] Other submissions said that s 53A should be widened in the way suggested in the DP.[119] The Legal Committee considers that s 53A should be expanded to permit the ASC to declare a company incorporated overseas but having sufficient nexus with Australia to be a Chapter 6 company.[120] Objective criteria for determining nexus should be specified in the legislation.[121]

Summary. The Legal Committee considers that downstream acquisitions in consequence of upstream acquisitions in companies that are listed in Australia or have an approved overseas exchange as their home exchange, whether or not incorporated in Australia, should be exempt from s 615. An exemption dependent on listing on approved overseas exchanges would encourage international comity by removing unwarranted obstacles to primarily foreign business transactions. That exemption would also overcome the present anomaly of different regulatory regimes applying to upstream companies listed on the ASX, depending on whether they are incorporated in Australia or overseas.

Downstream acquisitions resulting from upstream acquisitions in Australian or overseas incorporated companies that are not listed either on the ASX or on an approved overseas exchange should remain outside the exemption in s 629, though subject to ASC discretionary relief.[122]

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115 Proposal 17.

116 Corrs *Submission*, AARF *Submission*. The agreement of AARF was conditional on preventing a recurrence of the problem in the *Paringa* case.

117 Proposal 17.

118 The ASC examples were listing on an Australian stock exchange, registration as a member of an Australian company and being a beneficial owner of shares in an Australian company.

119 Rosenblum *Submission*, Corrs *Submission*, Mr Murdoch *Submission*.

120 Adoption of this view would deal with the ASC argument that the incorporation requirement was introduced to recognize that

> `the Listing Rules of ASX no longer regulate takeovers of listed foreign companies, as they did at the introduction of CASA in 1980. Therefore, simply restricting the relief to acquisitions in *listed* bodies would no longer ensure that the upstream acquisition is subject to appropriate takeover regulation and not simply a device to avoid regulation': ASC Policy Statement 71 para 8(a).

121 Corrs *Submission*.

122 The principles in ASC Policy Statement 71 paras 39-46 could apply in these cases.

(ii) Characteristics of the downstream company

Neither CASA nor the Corporations Law contain criteria which the downstream company must satisfy for the exemption to apply. The DP agreed with this position. No submissions were opposed.

(iii) Type of transaction

CASA did not restrict the type of upstream acquisition that attracted the exemption. In contrast, the Corporations Law requires that the upstream transaction occur as part of a takeover scheme or announcement for the upstream company or pursuant to an on-market acquisition under s 620 in the course of a takeover scheme. There was no stated policy for this additional requirement. The Supplementary Explanatory Memorandum to the Corporations Bill 1988 said, unhelpfully, that the requirement for a nexus with a takeover bid would `clarify and buttress the takeover provisions insofar as they apply to holding companies'.[123] The restriction to acquisitions in the course of takeover bids means that s 629 does not assist in the case of other types of downstream acquisition, for example, one resulting from a 3% creeping acquisition in an upstream listed company.

The DP proposed that the Corporations Law be amended to return to the position under CASA so that a downstream acquisition that results from any acquisition permitted by the Corporations Law[124] is also permitted.[125] Submissions supported this aspect of the DP proposal.[126]

Recommendation 19: Section 629 should be amended

- to return to the law as it stood under CASA s 12(k) by removing the reference in s 629(a) to incorporation in Australia and the limitation in s 629(b) on the type of permitted transactions
- to extend to downstream acquisitions that result from upstream acquisitions in companies that have an approved overseas exchange as their home exchange.

Recommendation 20: The overseas exchanges should be prescribed by regulations, after consultation with the ASC. The ASC should have the power to approve additional foreign exchanges. Overseas exchanges prescribed by regulation or declared by the Commission would be those of international standing and importance.[127]

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123 para 116.

124 This includes not only takeover offers and announcements but acquisitions pursuant to any of the exceptions to s 615.

125 Proposal 17.

126 ASC *Submission*, AARF *Submission*, Rosenblum *Submission*, Corrs *Submission*. AARF *Submission* said that if `restrictions are to be removed to permit any downstream acquisition that results from any upstream acquisition ... then shareholders should be made aware of all downstream acquisitions that result, for instance, from a s 623 acquisition'.

127 See footnote 108.

Recommendation 21: Section 53A should be amended to permit the ASC to declare a company incorporated overseas but having sufficient nexus with Australia to be a Chapter 6 company. Objective criteria for determining nexus should be specified in the legislation.

Part 3. Takeover schemes and takeover announcements

Date for determining shareholdings and identity of shareholders

Date unclear. Section 635 requires that an offer under a takeover scheme relate to all (or to a fixed proportion) of the shares in the relevant class of shares held by the offeree in the target company. Subsection 636(2) obliges the offeror to send an offer to each holder of shares in the relevant class. However, it is not clear whether the date for the purpose of these provisions is (taking the possible dates in chronological order)

- the date of signing the Part A Statement (signing date)
- the date of registering the Part A Statement (registration date)
- the date of service of the Part A Statement (service date)
- the date of the offers (offer date) or
- the date the offers are dispatched (dispatch date).

Problems. Current practice takes the relevant date to be the offer date.[128] However, this date, or any other date later than the signing date, may cause difficulties. If an offeror is obliged to make offers for any shares allotted after the signing date, it would be exposed to an increase in the maximum amount of possible offer consideration. This may not be provided for in the Part A statement. If the consideration is or includes cash, the bidder might not have arranged sufficient credit facilities to meet the increase. If the consideration is or includes shares, the maximum number of shares to be allotted might exceed the offeror company's unissued authorised share capital.

Proposal and submissions. Given these problems, the DP proposed that the offeror be permitted to choose a date for the purposes of ss 635 and 636(2) that is not earlier than the service date and not later than the offer date, being the same date in respect of each offer.[129] It may be appropriate to require the offeror to specify a time on the chosen date.[130]

The proposal received support in submissions.[131] However, two submissions disagreed. The Law Council argued that a date earlier than the service date was necessary to overcome the identified problems. The Legal Committee notes, however, that Part A statements are normally registered shortly after their lodgment[132] and can be served the next day. The Committee elsewhere recommends permitting their immediate service.[133] The possibility of an offeror being exposed to an increase in the offer consideration will therefore be slight if the service date is taken to be the earliest permissible date.

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128 The ASC accepts this practice notwithstanding its view that the relevant date is the dispatch date: see ASC Practice Note 7, paras 8, 12.

129 Proposals 18 and 19.

130 cf Exposure Draft Corporations Legislation Amendment Bill 1993 cl 249A, cl 1062A.

131 Rosenblum *Submission*, Corrs *Submission*. The ASX preferred that the legislation stipulate the service date as the relevant date, but was not opposed to the proposal in the DP.

132 Registration is deemed to occur by 5.00 pm the day after lodgment if it has not previously occurred or the ASC has not refused it: s 644(5).

133 Recommendation 29.

The ASC favoured a fixed date, being the offer date. The ASC pointed out that the possibility that an offeror company might be required to provide greater consideration than it anticipated could be overcome by making the offers conditional on the target company not allotting further shares.[134] However, the Legal Committee does not consider that an offeror should be forced either to make offers for a greater number of shares than it had anticipated or to allow its bid to fail. The ASC considered that the DP proposal could result in discrimination against shareholders who acquired shares in the target company after the date selected by the offeror, particularly if that date is as early as the service date. The Legal Committee considers that this potential for `discrimination' (if it can be so described) will remain no matter what date is chosen. The ASC also suggested that `it is now impossible for a purchaser to distinguish a newly issued share in a class (for which no offer might have been made) from an old one (for which an offer was made, on which section 649 would operate[135])'. Again, this problem will arise regardless of the chosen date.

s 699 problem. A major problem with any date later than the service date for the purposes of ss 635 and 636(2) is that the information received under s 699 may be insufficient.[136] The Securities Institute of Australia suggested that s 699 statements should be required to contain the information current on the date stipulated by the offeror for the purposes of ss 635 and 636. The Legal Committee agrees.

Recommendation 22: After the word `holds' in s 635(a) and (b), the words `at a time specified by the offeror, which is not earlier than the date of service of the Part A statement [service date] and not later than the date of the offer [offer date], being the same date in respect of each offer' should be inserted.

Recommendation 23: Subsection 636(2) should be amended by adding after the word `class':

> "as at the time specified by the offeror for the purpose of s 635".[137]

Recommendation 24: Section 699 should be amended to require the written statement to be accurate as at the time specified by the offeror for the purpose of s 635.[138]

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134 This is a prescribed occurrence as defined in paragraph (c) of the `prescribed occurrence' definition in s 603.

135 Section 649 deems the transferee of a share to be the person to whom an offer was made.

136 Section 699 enables an offeror to request a written statement setting out the names and addresses of shareholders, convertible note holders and renounceable option holders. The relevant date under this section is the service date.

137 This explicit link between the date chosen for the purposes of ss 635 and 636 was suggested by the ASC *Submission* and Rosenblum *Submission*.

138 The current s 699 stipulates the date of service of the Part A statement or the Part C statement. Recommendation 42 suggests a further amendment to s 699.

Permitted differences between offers: s 636(1)(b)

Paragraph 636(1)(b) provides an exception from the requirement that offers be identical. It permits differences in the offer consideration for shares having different accrued dividend entitlements or different paid up amounts (whether by way of capital or premium).

The principle underlying s 636(1)(b) is that offeree shareholders should be treated equally. The permitted differences in consideration are necessary to achieve this result. However, the provision is deficient, as it disregards differences in amounts unpaid. The offeror's potential liability for amounts unpaid may also be relevant in determining an offer price that achieves equality of treatment for shareholders.[139] The DP proposed that offerors should be permitted to disregard amounts unpaid as well as amounts paid up.[140] Submissions supported this proposal.[141]

Recommendation 25: The words `or unpaid' should be added after the words `paid up' in s 636(1)(b).

Partly paid shares

Recommendation 25, which would permit offer consideration to differ as a result of differences in amounts unpaid, as well as amounts paid up, on shares assumes that fully and partly paid shares are of the one class.[142] The ASC has taken the contrary view in a Practice Note.[143] It has identified two problems that may arise in a takeover bid if partly paid shares are not regarded as a separate class.

- The partly paid shares may have a negative price, where the amount unpaid on the shares is higher than their market price.
- There may be administrative difficulties in calculating the different prices for shares on which different amounts have been paid.

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139 The following example demonstrates that amounts unpaid can be relevant. An offer is made for a class of $1 shares in a company. Some of the shares have a 25c premium, others a 50c premium. The shares are fully paid to $1, and 20c of the premium has been paid in relation to both the shares that have a 25c premium and those that have a 50c premium. There is thus no difference between the shares in relation to the amount of premium that has been paid. However the amount unpaid differs, namely, 5c and 30c respectively. An offeror may legitimately want to offer different considerations due to these differences in the amounts unpaid on the premiums.

140 Proposal 20.

141 ASC *Submission*, Corrs *Submission*, Sly & Weigall *Submission*.

142 Refer to the discussion of Neasey J in *Clements Marshall Consolidated Ltd v ENT Ltd* (1988) 13 ACLR 90, 92-5.

143 ASC Practice Note 32, paras 17-20.

One submission argued that the ASC's view that fully and partly paid shares are separate classes is contrary to s 636(1)(b).[144] In contrast, another submission suggested that the law should state that partly paid shares do constitute a separate class of shares.[145] The ASC Practice Note favours the latter approach as a matter of policy as well as law. However, the Legal Committee sees difficulties in treating partly paid shares as a separate class. For instance, are shares partly paid to different amounts themselves different classes? If they are, it follows that, as further amounts are paid on shares, they would form new classes of shares or change from class to class. Moreover, it may be necessary, if partly paid shares are treated as a separate class, to

- provide that an offeror may use the same Part A statement for offers for both fully paid and partly paid shares[146]
- amend s 703 to ensure that the offeror must acquire the partly paid shares on request from their holders in the same manner as it must currently do for non-voting shares
- amend s 698 to allow contemporaneous offers for partly paid and fully paid shares.[147]

The Legal Committee recommends a simpler approach. The Corporations Law should provide that partly and fully paid shares are not, for that reason alone, separate classes of shares for the purpose of Chapter 6. Where there are other differences, for example, partly paid shares having reduced rights not proportional to the amount paid up, common law principles would determine whether there are separate classes. The ASC could also use its discretionary powers to modify Chapter 6, for instance to allow a bidder to make an offer only for fully paid, but not partly paid, shares (or vice versa), if appropriate.

Recommendation 26: The Corporations Law should provide that partly and fully paid shares are not, for that reason alone, separate classes of shares for the purpose of Chapter 6.

Requirement for offeror to send an offer to itself: s 636(2)

It is unclear whether s 636(2) requires an offeror which already holds shares in the target to send an offer to itself or, in the case of a joint bid, to each offeror holding target shares. CASA s 16(2)(c) required an offeror to send an offer to `each holder of shares in the target company (other than the offeror) included in the relevant class of shares'. The words `(other than the offeror)' were omitted from the Corporations Law.

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144 Sly & Weigall *Submission*.

145 Rosenblum *Submission*.

146 Section 634 requires that takeover offers relate only to one class of shares in the target company.

147 Rosenblum *Submission* acknowledged that these additional provisions would be necessary.

The ASC takes the view that s 636(2) requires the offeror to send an offer to itself.[148] The DP expressed difficulty with this concept and proposed that the uncertainty about the legislative intention be removed by adding to s 636(2) the words `(other than the offeror)'.[149] Submissions supported this proposal.[150] One suggested a further amendment to extend the exemption to shares to which an offeror is entitled.[151] The Committee does not agree. The breadth of the concept of entitlement could deprive shareholders who are only remotely associated with the offeror of the opportunity to receive offers.

Recommendation 27: The words `(other than the offeror)' should be inserted at the end of s 636(2).[152]

Payment of consideration: s 638(7)

Time for payment. Takeover offers must stipulate that the consideration for the offer is to be provided not later than 21 days after the close of the offer period: s 638(7). Offer documents typically

- reserve to the offeror a discretion to treat the receipt of an acceptance form as a valid acceptance even though the offeror does not receive the other documents necessary to establish title (such as share scrip, a power of attorney, probate or letters of administration)
- provide that the consideration will not be paid until the offeror receives all the requisite documents and all other requirements have been met.

However, there is a view that an offeror who wants to exercise a discretion to treat acceptances as valid must pay the consideration within the 21 day period under s 638(7). A requirement to pay consideration for property for which documents of title have not been received does not accord with ordinary commercial practice. If the offeror is not willing to risk paying without title, shareholders in the target company may be deprived of the opportunity to sell their shares.

Proposal and submissions. The DP proposed that s 638 be amended to remove the possibility that an offeror may be obliged to pay the consideration before receiving the documents of title.[153] The proposal was supported by submissions.[154]

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148 ASC Practice Note 7, para 17.

149 Proposal 21.

150 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*.

151 Corrs *Submission*.

152 The reference to `the offeror' would include each offeror in a joint bid: definition of `offeror' in s 603.

153 Proposal 23.

154 ASC *Submission*, Corrs *Submission*, AARF *Submission*. The ASX *Submission* proposed that seven days, rather than 21 days, may be more appropriate in the case of a cash offer. The Legal Committee considers that there should be a uniform time for providing consideration, whether the bid is a cash bid or a scrip bid. It therefore supports a uniform 21 day period.

One submission raised two additional concerns about the payment of consideration and the provision of documents of title.[155]

- There is no guarantee that an offeror will treat all shareholders who have provided invalid acceptances equally, that is, the offeror may choose to treat some acceptances as valid but not others.
- Where documents of title are not provided, there is no fixed time within which the offeror must decide whether or not to treat the acceptances as valid.

In relation to the first point, the Legal Committee notes that shareholders who are discriminated against can request the ASC to seek a declaration of unacceptable conduct from the Corporations and Securities Panel.[156] To provide greater protection in this instance would unnecessarily complicate and lengthen the Corporations Law. The second point is a matter for the offeror to state in the offer document, and does not require statutory regulation.

Recommendation 28: A new s 638(8) should be inserted as follows:

"A provision may comply with subsection (7), notwithstanding that it provides that:

(a) where an offer is accepted but documents sufficient to enable the offeror to become the holder of shares to which the offer related are not provided to the offeror with the acceptance, the consideration for the offer shall be paid or provided within:
  (i) the time specified in accordance with subsection (7); or
  (ii) twenty-one days after the day on which the documents are provided,
whichever is the later; and

(b) the contract resulting from acceptance of the offer may be avoided at the option of the offeror if the documents are not provided within one month after the end of the offer period.[157]".

Timing: ss 644 and 647

Service and registration of Part A statement. In contrast to the position under CASA,[158] a Part A statement may not be served on the same day it is registered.[159]

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155 Prof Little *Submission*.

156 s 733.

157 This is intended to enable the offeror to settle its position under s 701.

158 CASA s 18(1) provided that a Part A statement must have been registered `not earlier than 21 days before' the Part A statement is served. This wording permitted service on the day of registration.

The DP suggested that this is an unintended consequence of the change of wording between CASA and the Corporations Law.[160] The DP proposed that the Corporations Law be amended to permit registration and service on the same day.[161]

Submissions. Submissions supported the proposal.[162] However, the ASC noted that `because Part A statements are usually deemed to be registered pursuant to subsection 644(5) (ie at 5.00 pm on the next business day following lodgment), service on the same day as registration would effectively shorten by a day the time that a target company has to prepare its Part B statement'. The ASC suggested that the DP proposal should be accompanied by a further proposal that the 14 day period in s 647(1) be extended to 15 days. The Legal Committee agrees.

Recommendation 29: The words `the day immediately before' should be deleted from s 644(1) and the 14 day period in s 647(1) should be extended to 15 days.

Part B statements: s 647

Subsection 647(1) requires a target company to give a Part B statement either

- to the offeror before the end of 14 days after receiving the Part A statement, in which case the offeror must send the Part B statement to offeree shareholders with the offers (s 639(2)) or
- to the offeror and offeree shareholders before the end of 14 days after it receives notice from the offeror under s 646(1) that offers have been sent.

The Securities Institute of Australia raised a doubt whether s 647 would permit `a friendly target company to arrange for the offeror to dispatch the Part B statement to target shareholders, together with the offer document and Part A statement, later than 14 days after the target company's receipt of the Part A statement'. It suggested this be expressly permitted. The Legal Committee questions whether this is necessary. The combined effect of ss 647(1)(a) and 639(2) (which obliges an offeror to send the Part B statement in some circumstances) does not prevent the offeror from sending

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159 Subsection 644(1) requires registration `within the 21 days ending on *the day immediately before* the day on which the statement is served'. Under this wording the period during which registration must take place ends on the day before the statement can be served. See also ASC Media Release 91/104, ASC Practice Note 19, para 11.

160 The differences between s 644 and CASA s 18 were discussed at paragraphs 2000-2005 of the Explanatory Memorandum to the Corporations Bill 1988. However, no reference was made to the change affecting the date of service and registration of Part A statements.

161 Proposal 22.

162 ASC *Submission*, Corrs *Submission*, AARF *Submission*. The Law Council *Submission* suggested using the phrase `21 day period' instead of `21 days'. The Legal Committee does not consider this wording to be superior to that proposed by the DP.

the Part B statement in other situations. Similarly, a target company can arrange for the offeror to give offerees the Part B statement as required by s 647(1)(b).[163]

Offeror connected with the target: s 648

Subsection 648(1) requires that an independent expert's report accompany a Part B statement where the offeror is entitled to not less than 30% of the voting shares or a class of voting shares in the company. One submission suggested that it is not clear when the offeror must have that entitlement.[164] It proposed that the entitlement date be the date of the Part B statement (the Part B date). The Legal Committee agrees that clarification is required, but questions the feasibility of the proposed date. Directors of the target will need to know well in advance of the Part B date whether they are obliged to commission a report. A more practical date for determining the 30% entitlement would be the date of service of the Part A statement on the target. The submission expressed concern about the possibility of offerors acquiring a significant shareholding in the period between service of the Part A statement and the Part B date.[165] However, the Legal Committee does not consider that an offeror would have any real opportunity to increase its influence on the target board of directors in that relatively short period and thereby affect the content of the Part B statement.

Recommendation 30: Subsection 648(1) should be amended to provide expressly that an independent expert's report must accompany the Part B statement where an offeror is entitled to not less than 30% of the voting shares, or a class of voting shares, in the target company at the date of service of the Part A statement on the target company.

Variation of consideration: s 655

Section 655 sets out specific ways an offeror may vary the consideration specified in a takeover offer. None of these permit an offeror who has made an offer to acquire shares cum dividend to vary the offer to permit offerees to retain the dividend.[166] The DP proposed that the Law should specifically permit this variation.[167] Submissions supported the proposal.[168] Some were concerned to ensure that offerees who have already accepted an offer receive the dividend to which the revised offer entitles

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163 Section 52 provides that a `reference to doing an act or thing includes a reference to causing or authorising the act or thing to be done'. The Legal Committee agrees with the view expressed in ASC Practice Note 33 para 6:

> `Although the target is obliged to dispatch copies of the Part B, it may discharge this obligation by causing another person to dispatch the copies (s 52). The other person can as well be the offeror as a registry manager or mailing house.'

164 Sly & Weigall *Submission*.

165 Under s 620 a bidder may acquire shares on-market immediately after service of the Part A statement.

166 The ASC agrees in principle that this type of variation should be permitted: ASC Practice Note 4, para 7.

167 Proposal 24.

168 ASC *Submission*, Rosenblum *Submission* (subject to a drafting point which has been reflected in the Committee's recommendation), Corrs *Submission*, AARF *Submission*.

shareholders.[169] In the Legal Committee's view, the dividend would constitute increased consideration for acquisition of the shares which accepting shareholders would be entitled to receive under s 655(2). There is no need to make separate provision.

The Law Council suggested that the proposal be extended to distributions other than dividends. The Legal Committee is concerned that a wider extension may create uncertainty. It notes that other variations can be made with the consent of the ASC and does not support a further extension of the variations specifically permitted by s 655.

Recommendation 31: Section 655 should be amended by adding a new subsection (1A) as follows:

> "Where an offeror has made an offer under a takeover scheme to acquire shares with the right to receive a dividend attached to the shares, the offeror may vary the offer by providing that the offeree may be paid or may retain all or part of the dividend.".[170]

Extension of offer period under a takeover scheme

Section 656 permits conditional or unconditional offers under a takeover scheme to be extended. However, procedural restrictions apply to extending conditional offers.[171] The ASC *Submission* expressed concern that a conditional offer that is subsequently declared to be unconditional may not be treated as unconditional for this purpose. The Legal Committee does not consider that this concern is justified. An offer that has been declared free of conditions can no longer be treated as conditional. In the Committee's view, no legislative amendment is required.

Prohibition of certain conditions: s 662(2)

Prohibition too narrow

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169 ASC *Submission*, Corrs *Submission*.

170 The Law Council *Submission* suggested the following draft provision to the same end:

> `Where an offeror has made an offer under a takeover scheme to acquire shares and as a term of that offer a dividend which is or has been declared or is payable would become the property of the offeror then the offeror may vary the offer by exempting any particular dividend or part thereof from such condition which dividend or part thereof shall then be retained by the offeree.'

171 Conditional offers may only be extended before a date, specified in the offer, that is not less than 7 days and not more than 14 days before the last day of the offer period. This follows from ss 656(1)(a), 663(4), 663(5) and 638(5). Unconditional offers may be extended at any time before the end of the offer period.

The prohibition. Paragraph 662(2)(b) prohibits a takeover offer that is subject to any defeating condition the fulfilment of which depends on a particular event `that is within the sole control of the offeror or of an associate of the offeror'.

Proposal and submissions. The DP suggested that this prohibition is too narrow. It proposed that it be widened to include the offeror and/or one or more associates acting together.[172] The proposal was supported by several submissions.[173] The ASX suggested that the legislation also refer to events that are `a direct result of action' by the specified parties, as well as events that are in their sole control. The Legal Committee agrees.

The Law Council queried whether including a reference to associates `acting together' resulted in the DP proposal being too far-reaching.[174] The Legal Committee intends that the phrase `acting together' have a similar meaning and effect to the term acting `in concert'.[175] It does not intend that the phrase apply to persons acting independently of each other.

The ASC observed that the DP proposal would not deal with offerors who make offers conditional on events that do not depend on themselves or a related person, but are nevertheless certain to occur.[176] When the event occurs, the offeror could rely on or abandon the condition. The ASC proposed `prohibiting a defeating condition which is more than likely to operate, unless it relates to a prescribed occurrence or is approved by the ASC'. The Legal Committee recognizes the ASC's concern about offerors effectively giving themselves an option whether or not to proceed with the bid. However, the Committee queries whether it is possible to legislate effectively in this area. Rather, the ASC can apply to the Corporations and Securities Panel for a declaration of unacceptable conduct where an offeror is seeking to use a condition in an unacceptable manner.[177]

Recommendation 32: Paragraph 662(2)(b) should be repealed and replaced with the following paragraph:

> "(b) whether or not a particular event happens, being an event that is within the sole control of, or is a direct result of action by:
> (i) the offeror;
> (ii) an associate of the offeror;
> (iii) associates of the offeror acting together; or

172 Proposal 25.

173 Rosenblum *Submission*, Corrs *Submission*, ASX *Submission*, AARF *Submission*.

174 The Law Council *Submission* argued that the associates of the offeror, when `acting together', could be totally unrelated to each other. For example, if a condition requires shareholder approval to be obtained and the major shareholders are associates of the company but have no agreement or association between them, the fact that they may independently vote in the same way may be caught by the DP's proposed s 662(2)(b)(iii).

175 s 15(1)(a).

176 An example would be a condition which would effectively permit an offeror for a target company conducting an export business to withdraw if the Australian dollar is worth more than US$0.10 at a stipulated time.

177 s 733.

(iv) the offeror and an associate or associates of the offeror acting together.".

Prohibition too wide

Target related. The DP stated that s 662(2)(b) is too wide in one respect: defeating conditions should be prohibited only if the offeror, either by itself or through or in concert with associates, can influence whether the defeating event occurs. As presently drafted, s 662(2)(b) would apply to a defeating condition that is within the sole control of a target company which is an associate of the offeror by reason only of being a related corporation.[178] The DP proposed that the provision should not apply in this case.[179] The directors of the target company must act in the interests of the target in determining whether to cause a prescribed occurrence to occur. Where the directors trigger a prescribed occurrence, it is appropriate for the offeror to have the right to withdraw the bid.

Submissions. The proposal was supported in submissions.[180] However, the ASC `questioned, as a matter of principle, whether it is consistent with the concept of related bodies corporate to make an exception which is based on the assumption that an offeror will in certain situations have no control over its related bodies corporate'. The Commission also raised doubts about how abuses of the proposed provision could be effectively challenged.[181] It `preferred that offerors be left to seek relief from the ASC as and when they can establish that such a modification as that proposed should be granted under the ASC's existing powers'.

The Legal Committee does not agree. Actions by the target company to trigger defeating conditions, contrary to the interests of the target and its shareholders, may be challenged, for instance, under s 260 (oppression) or s 733 (unacceptable conduct). Moreover, directors of the target may be in breach of their fiduciary duties and the offeror and its directors may also be liable as accessories. These sanctions are adequate to counter possible abuse. This is not a case where offerors should be left to seek relief from the ASC.

Recommendation 33: A new s 662(2A) should be inserted as follows:

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178 Related bodies corporate are associates: s 11(b). Section 50 sets out the circumstances in which bodies corporate are related. See also the definition of `subsidiary' in s 46.

179 Proposal 25.

180 Rosenblum *Submission*, Corrs *Submission*, ASX *Submission*, AARF *Submission*.

181 The Commission said: `A person who seeks to challenge reliance on such an exception would be faced with the usual difficulty encountered when required to adduce evidence of intention, a potential problem which is likely to encourage offerors to exploit the exception.'

> "A reference to an associate in paragraph (2)(b) does not include the target company or a subsidiary of the target company where the target company or the subsidiary (as the case requires) is an associate of the offeror by reason only of the operation of paragraph (b) of section 11.".

Declaration where takeover offers are conditional: s 663

Requirement to declare offers unconditional. Where

- conditional offers are made under a takeover scheme
- the offers have not been declared or become free from the conditions and
- the conditions have not been fulfilled at the end of the offer period

all contracts resulting from the acceptance of offers and all acceptances that have not resulted in binding contracts are void: s 663(9). An offeror who intends to declare takeover offers free of a condition must do so not less than seven days before the last day of the offer period: s 663(2).

This requirement for early declaration may give rise to unreasonable consequences. The DP noted that an offeror may, for good reason, want to retain the protection of `prescribed occurrence' conditions[182] during the final seven days of the offer period. However, s 663(2) prevents the offeror from declaring offers free from such conditions in that seven day period. The takeover scheme will fail completely if any event covered by a remaining prescribed occurrence condition occurs in that period. The DP therefore proposed that an offeror under a takeover scheme have up to three business days after the end of the offer period to declare the offer free of a prescribed occurrence defeating condition.[183] This three day period would allow the offeror sufficient time to consider all relevant events concerning prescribed occurrences up to the end of the offer period.

Submissions. Several submissions supported the proposal.[184] However, the ASC disagreed. It considered it `contrary to the policy of section 663 that offerees should have to accept offers without knowing the status of a defeating condition and then have to wait 3 days after the close of the offer period to know whether their offers are final'. The Legal Committee considers that this view ignores the present unwarranted advantage to offerees if the conditions are lifted, and the uncertainty and

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182 The matters that constitute prescribed occurrences are set out in the definition of `prescribed occurrence' in s 603 and include
- a resolution of the target company or a subsidiary for reduction of capital
- an allotment of shares by the target company or a subsidiary and
- the disposal by the target company or a subsidiary of the whole or a large part of its business or property.

183 Proposal 26.

184 Rosenblum *Submission*, Corrs *Submission*, ASX *Submission*, AARF *Submission*.

unsatisfactory consequences which may follow if they are not.[185] An offeror should have sufficient time to consider all relevant events concerning prescribed occurrences up to the end of the offer period. The only matter of which offerees would be unaware under the DP proposal would be whether or not prescribed occurrence defeating conditions had been abandoned, and then only for a maximum of 10 extra days.

Some submissions, while supporting the DP proposal, suggested that it should extend to any condition permitted under s 662, not just prescribed occurrence defeating conditions.[186] The Legal Committee disagrees. The prescribed occurrences all concern specific matters relating to the capital structure, financial standing and solvency of the target company. A bidder might reasonably be given an additional period after the close of the bid to consider whether to abandon conditions relating to the position of the target company. The variety of other possible conditions is so open-ended that to include them could give the bidder an unfair or unjustified discretion. For instance, it would be undesirable to permit a bidder to decide the status of a minimum acceptance condition after the close of the bid. Offerees may be unfairly disadvantaged.[187]

Notice of condition status. The ASX proposed that there should be a requirement for offerors to publish a notice of the status of conditions within two business days after the end of the three day post-offer period. The Legal Committee supports the introduction of a Listing Rule to this effect.

Recommendation 34: Paragraph 663(2)(a) should be replaced with the following:

> "(a) it is a term of the offer that the offeror may do so:
>
> (i) in the case of a condition that a prescribed occurrence does not occur in relation to the target company, not more than three business days after the last day of the offer period; or
>
> (ii) in any other case, not less than seven days before the last day of the offer period;
>
> and the offer is declared to be free from the condition in accordance with that term;".

Recommendation 35: Paragraph 663(9)(b) should be replaced with the following:

> "(b) at the end of the offer period:
>
> (i) the offers have not become free from the condition by the operation of subsection 664(2); and

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185 The DP pointed out that an offeror may be willing for a takeover scheme to proceed notwithstanding, for instance, that some new shares have been allotted in the target company or a subsidiary. It is even conceivable that the offeror, the accepting shareholders and the target company may not realize for some time, or at all, that the takeover scheme has failed.

186 ASX *Submission*, AARF *Submission*.

187 For example, a bidder may include a 50% minimum acceptance condition in its bid and reach 40% acceptances 7 days before the close of the bid. Remaining shareholders, anticipating that the bidder may not achieve the 50% threshold, may only want to sell if the bidder declares the offer free of the minimum acceptance condition. Those shareholders will be unable to make an informed decision if the bidder can wait until after the close of the bid to make such a declaration.

"(c) (ii) the condition has not been fulfilled; and the offeror has not declared the offers to be free from the condition within the applicable period specified in subparagraph (2)(a)(i) or (2)(a)(ii);".

Recommendation 36: The ASX should introduce a Listing Rule requiring offerors for shares in listed companies to publish a notice of the status of `prescribed occurrence' conditions within two business days of the end of the three day post-offer period.

End of offer period under a takeover announcement

Under ss 674, 678 and 681(3), offers under a Part C announcement must remain open for a calendar month and any extension must be for an additional month at a time. The closing date for a bid is uncertain where the month ends on a weekend or public holiday. The ASC *Submission* pointed out that, while an initial bid can be timed to end on a trading day, an extension may well finish on a weekend. It suggested that the Corporations Law be amended so that offers constituted by a takeover announcement are open for 20 trading days of the target company's home stock exchange, commencing 10 trading days after the announcement, and can be extended for a further 20 trading days at the end of each period.[188] The Legal Committee agrees.

Recommendation 37: The Corporations Law ss 674, 678 and 681(3) should be amended so that offers constituted by a takeover announcement are open for 20 trading days of the target company's home stock exchange, commencing 10 trading days after the announcement, and can be extended for a further 20 trading days at the end of each period.

Prohibitions on certain benefits: s 698

Subsections 698(1) and (3)

Policy of s 698. The policy of s 698 is to prevent the giving of inducements to accept a takeover offer which are not equally available to all shareholders. As presently drafted, however, s 698(1) and (3) may be construed as prohibiting the giving of any benefits to an offeree, whether or not the offeror intends the benefits to be an inducement to accept its offers. In particular, the subsections may be construed as applying to payments made by the offeror in the ordinary course of its business.

Proposal. The DP proposed that the prohibition under s 698(1) and (3) on the giving of benefits should be limited to benefits offered in connection with the acquisition or possible acquisition of a person's shares under a takeover scheme or announcement.[189]

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188 Similar terminology is already used in s 603 to define `closing phase' for the purposes of ss 677(1) and 681(3)(a).

189 Proposal 28.

Submissions. Some submissions supported the proposal.[190] However, the ASX proposed a narrower exemption, namely that the current prohibition in s 698(1) and (3) remain, other than for `benefits which could not reasonably be expected to have any influence on a target shareholder's decision to accept an offer'. The ASC submitted that s 698(1) and (3) remain unchanged but a defence to a breach of these provisions be available to an offeror who `can show that a benefit has been conferred other than in connection with the acquisition of a person's shares under the takeover scheme or announcement'. The Legal Committee agrees with the ASC's suggested approach.

Recommendation 38: The Corporations Law should be amended to provide that no breach of s 698(1) and (3) occurs where the offeror establishes that the benefit has been conferred other than in connection with the acquisition of a person's shares under the takeover scheme or announcement.

Subsections 698(2) and (4)

Anomalies. Subsections 698(2) and (4), which had no equivalent in CASA, prohibit the giving of discriminatory benefits where a takeover bid is proposed.

The DP noted that the Queensland Court of Appeal in *Magellan Petroleum Australia Ltd v Sagasco Amadeus Pty Ltd*[191] gave s 698(2) a wide interpretation which would prohibit an intending bidder from acquiring any shares in the proposed target company in the four months before the bid, except for acquisitions in the ordinary course of stock market trading (as permitted by s 698(5)). The Court referred to the view that the wide interpretation `would prohibit the buying of shares off-market for cash during the four month period because the vendor would receive the benefit of immediate cash payment'.[192]

After release of the DP, a majority of the High Court in the same matter interpreted `benefit' more narrowly. The Court rejected the view that `mere acquisition of shares in a company, even at the same price as that later offered under a takeover scheme, would confer a benefit upon shareholders whose shares were acquired before the commencement of the takeover period in that they would receive the price at an earlier time'.[193] The majority said:

> `The price paid for shares, whenever paid, is consideration for the shares and earlier payment means relinquishing the shares and the rights that go with them at an earlier date. Mere earlier payment would not, therefore, constitute a benefit for the purposes of s 698(2).'[194]

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190 Rosenblum *Submission*, Corrs *Submission*.

191 (1992) 9 ACSR 162.

192 At 167.

193 *Sagasco Amadeus Pty Ltd v Magellan Petroleum Australia Ltd* (1993) 10 ACSR 398, 403.

194 Ibid. McHugh J disagreed. He saw earlier payment as a benefit. He said:

The High Court, however, did not make it clear whether this principle applied only to later *unconditional* cash bids or also to later *conditional* bids, especially, for instance, a later bid subject only to prescribed occurrence conditions.[195] The Legal Committee is concerned that these subsections will continue to have the apparently unintended consequence of fettering unduly an offeror's freedom to acquire shares on-market or otherwise up to a 20% entitlement in the target company before launching a takeover offer.

As the DP noted, these subsections also expose an associate of the proposing offeror to liability for breach even if the associate is unaware of the proposing offeror's intentions regarding the giving of benefits. The DP proposed repeal of s 698(2) and (4).[196]

Submissions. Some submissions supported the proposed repeal.[197] However, others objected.[198] The essence of their objections was that the principle of equality of opportunity for shareholders under a proposal by which a person would acquire a substantial interest in the company[199] should apply to the four month period preceding the making of a takeover offer.

The Legal Committee disagrees with these objections. It considers that the policy underlying s 698(2) and (4) is misconceived and that the proper focus of takeover regulation is equality of opportunity for shareholders after, but not before, the bid has commenced. The philosophy of the legislation is to permit unrestricted acquisitions up to the 20% entitlement limit: it is only then that limitations should be imposed on offerors. The prohibition on escalation agreements (s 697) forbids a shareholder who sells in advance of a takeover offer to participate in any increased benefits provided under the takeover offer. Thus, it does not necessarily follow that an offeror who pays a different consideration to a shareholder selling in advance of a takeover offer discriminates in that shareholder's favour. An early seller may do better or may do worse. The important point is that all shareholders whose shares are the subject of the takeover offer itself have an equal opportunity to participate in any benefits provided by the offeror.

The Legal Committee also considers that alternative approaches to repeal of the subsections mentioned in some submissions (for example excluding the time benefit

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> `At least in the case where no dividends or other benefits will be derived from the shares in the period between the off-market acquisition and the takeover acquisition, early payment must be a benefit to the shareholder who sells before the takeover date. The quantum of the benefit will depend on the length of the period and the current interest rates. But except in the case where the period is so short that it can be disregarded for practical purposes, early payment must be a benefit even when the nominal sale price of both lots of shares is the same.'

195 D Reichel, `Collateral benefits prior to takeovers - The High Court's decision in *Sagasco v Magellan*' [1993] *Butterworths Corporation Law Bulletin* No 11 at [186].

196 Proposal 27.

197 Rosenblum *Submission*, Corrs *Submission*.

198 ASC *Submission*, ASX *Submission*, Mr Constable of Freehill Hollingdale & Page *Submission*.

199 The fourth Eggleston principle: s 731(d), s 732(d).

of money and savings in brokerage and stamp duty from the definition of `benefit'[200]) do not deal with the misconception on which s 698(2) and (4) are based.

One submission, while opposing the repeal of s 698(2) and (4), noted that if `the 4-month rule is to be removed from section 698, it should also be removed from sections 641 and 676' to `ensure cash and non-cash pre-bid transactions are dealt with consistently'.[201] The Legal Committee considers that ss 641 and 676 are themselves anomalous and should, strictly, be repealed, although the Committee does not make a recommendation to this effect. The anomaly was exacerbated by the introduction of s 698(2) and (4).

The ASC said that if s 698(2) and (4) are repealed, s 698(1) and (3) should be amended `to catch benefits provided after the offer period has closed pursuant to an agreement entered into before the offer period commences, where the making of the agreement or the provision of the benefit during the offer period would have been prohibited by section 698'. The Legal Committee does not consider the ASC's proposed amendment necessary, as the matter is already dealt with by the anti-escalator provision in s 697 which includes benefits given after close of the bid.

Recommendation 39: Subsections 698(2) and (4) should be repealed.

Simultaneous offers for different classes of securities

The prohibition in s 698 on giving collateral benefits prevents an offeror from making simultaneous offers for different classes of securities. NCSC Release 160, which has not been reviewed by the ASC, states that the Commission will modify s 698 if satisfied that the simultaneous offers do not attempt to induce acceptances of offers for voting shares.[202] One submission considered this approach unnecessarily restrictive and proposed that the section should be amended to permit simultaneous offers for different classes of securities.[203] Abuses could be dealt with by an application to the Corporations and Securities Panel.[204] The Legal Committee agrees.

Recommendation 40: Section 698 should be amended to permit simultaneous offers for voting shares and other classes of securities in the target company.

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200 ASC *Submission,* Mr Constable of Freehill Hollingdale & Page *Submission*.

201 Mr Constable of Freehill Hollingdale & Page *Submission*.

202 NCSC Release 160 para 13 states:

> `The question is whether the consideration proposed to be offered for the other securities is a collateral benefit which is likely to induce offerees to accept offers for voting shares which they would not otherwise have accepted.'

203 Sly & Weigall *Submission*.

204 s 733.

Subsection 698(5)

Paragraph 698(5)(b) provides that the prohibitions in s 698 on giving collateral benefits do not apply to the acquisition of shares in a company in the ordinary course of stock market trading. The DP proposed that this exemption also apply to acquisitions of other securities on the stock market.[205]

Submissions supported the proposal.[206] The Legal Committee has considered whether its proposal may give rise to market manipulation by an offeror privately agreeing to purchase other securities owned by an offeree shareholder through the Stock Exchange as an inducement for that shareholder to accept the offer. The Committee notes case law which supports the proposition that such dealings would not be part of the `ordinary course of trading' on a stock market and would therefore not fall within the exemption.[207]

Recommendation 41: Paragraph 698(5)(b) should extend to securities of a company other than shares.

Names and addresses of shareholders: s 699

Section 699 enables an offeror to obtain a `written statement' setting out, inter alia, the names and addresses of the shareholders in the target company. This provision does not enable the offeror to require the target company to provide address stickers or a computer disk with names and addresses, even where they can be produced from the register of members. A hostile target company could thus put an offeror to the considerable and unnecessary expense of producing its own address stickers. The DP proposed that s 699 be amended to enable offerors to require information in the most convenient form possible using the technology of the target company.[208] Submissions supported this proposal.[209]

Recommendation 42: Section 699 should be amended to enable an offeror to require the names and addresses of shareholders in the target company to be made available in a form which is stipulated by the offeror and permitted by the technology of the target company, provided that the offeror bears the reasonable cost of doing so.[210]

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205 Proposal 29.

206 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*.

207 See generally L Vary, `"In the Ordinary Course of Trading" - Extraordinarily Unclear in Practice' (1993) 11 C&SLJ 253.

208 Proposal 30.

209 ASC *Submission*, Rosenblum *Submission*, Corrs *Submission*, AARF *Submission*.

210 Recommendation 24 suggests a further amendment to s 699.

Public announcements: s 746

Section 746 requires persons to make a takeover bid within two months of announcing their intention to do so. One submission suggested that s 746 be amended to state that lodgment and registration of a Part A statement alone do not amount to a `public announcement'.[211] Currently, a Part A statement, when lodged with the ASC, is publicly available.[212] The Legal Committee considers that such lodgment does amount to a public announcement of a takeover offer[213] and that it is appropriate that the two month period run from the time of lodgment.

References to `amount' in Part A and Part C of s 750

Clause 15 of Part A and clause 12 of Part C relate to agreements whereby the offeror may transfer shares acquired pursuant to the takeover. The ASC *Submission* suggested that the reference in the clauses to the `amount' of shares that will be transferred is confusing, particularly as the clauses separately refer to `amount', `number' and `description'. The Commission proposed clarifying whether `amount' means the par value of the shares, the consideration to be paid to the transferee or something else. The Legal Committee does not consider that there is a difficulty of interpretation. In its view, the term `amount' refers to the nominal amount or par value of the shares.[214]

Use of Part A statement in secondary trading

The Corporations Law before commencement of the Corporate Law Reform Act 1993 requires a prospectus for any secondary trading in quoted or unquoted securities, unless there is a specific exception.[215] One submission suggested that holders of securities issued as consideration under a Part A statement should be able to participate in secondary trading in those securities during the bid without any additional prospectus obligation.[216] Under the Reform Act amendments, this issue will not arise for secondary trading in quoted securities, as these transactions will be exempt from the prospectus provisions.[217] However, under the Reform Act, secondary

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211 Sly & Weigall *Submission*.

212 s 1274(2)(a).

213 Cf *TNT Australia Pty Ltd v Normandy Resources NL* (1989) 1 ACSR 1, where the Court held that the service of a Part A statement on the Stock Exchange constituted a public announcement. O'Loughlin J said (at 26) that the Stock Exchange `is a prime source for the dissemination of information to the stockbroking and financial communities and, through them, to the public and to members of the target company'.

214 The word `amount' has this meaning elsewhere in the Corporations Law, eg s 117(1)(b).

215 For example ss 66, 1017, 1018(2), (5).

216 Corrs *Submission*.

217 The Act amends s 1018 to prohibit only primary issues of securities without a prospectus. The limitations on secondary trading are confined to Pt 7.12 Div 3A which applies only to unquoted securities.

trading in unquoted securities will require a notice, though not a prospectus.[218] The Legal Committee recommends that a Part A statement should be taken as satisfying this notice requirement during the bid. This should apply to any secondary trading in unquoted securities of the class offered under a bid, whether or not the securities were issued pursuant to that bid.

Recommendation 43: A registered Part A statement offering unquoted securities as consideration under the bid should be taken to satisfy the notice requirements of ss 1043C and 1043D for secondary trading in that class of securities during the currency of the Part A statement.

218 Pt 7.12 Div 3A. Where the securities involved constitute 30% or more of the voting shares in the company, the notice will be similar to a prospectus: s 1043C(2). Otherwise, a more limited notice will be required under s 1043D.

Part 4. ASC powers

Restrictions on ss 728 and 730 as class order powers

Sections 728 and 730 permit the ASC to give exemptions from, or modify, the Corporations Law. The ASC *Submission* identified several problems with them.

- The sections may not apply to `a class of cases'.
- An application for modification or exemption can only be made for a class of persons by one of the persons in that class. The ASC commented that, as `a matter of convenience, a company may desire to make an application on behalf of a class of shareholders (eg participants in a dividend reinvestment plan) but seems to be prevented from doing so by the terms of sections 728 and 730'.

The ASC proposed that the section include `a class of cases' and that the class of applicants should be extended to `a company or companies of which the person concerned is a shareholder or the persons concerned are shareholders, or any authorised agent of the person or persons concerned'. The Legal Committee agrees.

Recommendation 44: Sections 728 and 730 should be extended to a class of cases and should permit applications to be made by a company of which the person concerned is a shareholder or the persons concerned are shareholders, or any authorised agent of the person or persons concerned.

Power to modify Chapter 1 definitions

Section 730 gives the ASC power to omit, modify or vary specified provisions of Chapter 6 for various persons. The ASC *Submission* pointed out that many provisions applicable to Chapter 6 are in Chapter 1[219] and that the Commission could more appropriately grant modifications to an applicant or class of applicants if it could also modify relevant definitions in Chapter 1. The Legal Committee agrees.

Recommendation 45: Section 730 should be amended to permit the ASC to omit, modify or vary provisions of Chapter 1 in so far as they affect the operation of Chapter 6.

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219 For example, the definitions of `associate' (Pt 1.2 Div 2), `relevant interest' (Pt 1.2 Div 5), `subsidiary' and `related body corporate' (Pt 1.2 Div 6) and acquisition and disposal of shares (s 51).

Part 5. Other matters

Penalties for Chapter 6 breaches

The ASC *Submission* said that it would be desirable to review the penalties for contraventions of Chapter 6. It questioned why a person who falsely or recklessly announces a bid which is not intended, in breach of s 746(2), should incur a penalty of $20 000, whereas a person who acquires a controlling interest in a company in breach of s 615 should only incur a penalty of $2 500. The Legal Committee considers that penalties for breaches of the Corporations Law are a matter for the Government to determine, but draws this apparent anomaly to its attention.

Use of courier

Corporations Regulations reg 6.1.01 stipulates approved ways of sending takeover documents. A document may be sent to a person in an external territory or outside Australia by pre-paid airmail post. In other cases, a document may be sent by pre-paid ordinary post or courier. The ASC *Submission* suggested that there is no policy reason against permitting a document to be sent by courier to a person in an external territory or outside Australia. The Legal Committee agrees.

Recommendation 46: The words `or by courier' should be added to paragraph (a) of Corporations Regulations reg 6.1.01 after the word `post'.

Form 602A

The ASC *Submission* noted technical deficiencies in Form 602A, prescribed for an offeror to notify dissenting offerees of its desire to compulsorily acquire their shares.

- Paragraph 6 of the Form refers to `dissenting offerors' rather than `dissenting offerees'.
- The words `to which this notice relates' could be added after `the outstanding shares' in the first line of paragraph 8 `to make it clear that the offeror is only bound to acquire those shares in relation to which it sends a Form 602A notice'.

The Legal Committee agrees that appropriate amendments should be made to the Form.

Recommendation 47: Form 602A should be amended by changing `dissenting offerors' to `dissenting offerees' in paragraph 6 and by adding the words `to which this notice relates' after the words `the outstanding shares' in the first line of paragraph 8.

Explanatory Memorandum for proposed legislation

The ASC *Submission* suggested that the Explanatory Memorandum to any proposed legislation implementing the recommendations of this Report should contain `full and precise details of the intended purpose and operation of the proposed provisions'. The Legal Committee notes that relevant reports of the Advisory Committee can be used as extrinsic material in interpreting the Corporations Law.[220] However, the Committee supports the ASC suggestion that the Explanatory Memorandum include the reasons for, and the intended effect of, the changes recommended in this Report.

Time periods

One submission questioned whether a reference to days and months in the takeovers provisions means clear days or clear calendar months.[221] There are differing views on the interpretation of the law.[222] The Legal Committee considers that this problem is not confined to takeovers and requires a more general review, possibly by the Simplification Task Force. However, the Legal Committee elsewhere recommends that the expressions `10 trading days' and `20 trading days' be substituted for the expressions `14 days' and `one month' respectively in one context.[223]

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220 s 109J(3)(b).

221 Prof Little *Submission*.

222 In *Re Kargat Pty Ltd* (1989) 15 ACLR 527, Bryson J took the view that the offeror could reckon time in units less than whole days. The ASC requires clear calendar months or days: ASC Practice Note 19. *Forster v Jododex Australia Pty Ltd* (1972) 127 CLR 421 supports the ASC view.

223 Recommendation 37.

Part 6. Further Policy Issues

This section of the Report lists various policy issues, going beyond takeover anomalies, that have come to the attention of the Legal Committee in the course of its review. These issues, some of which the Legal Committee may further examine, are:

- the possibility that the money-lending exemptions from the takeovers provisions could be used to gain control of a company[224]
- whether the interest that a person has in shares should be disclosed in a substantial shareholding notice even though it may be disregarded as a relevant interest for other purposes[225]
- whether an offeror should be prevented from increasing its price during the last week of the offer period unless that period is extended[226]
- whether an offeror should be required to disclose details of the source of finance for a takeover bid or only whether it intends to use its own funds or borrowed funds[227]
- whether the circumstances in which an independent expert's report is required should be extended.[228]

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224 Rosenblum *Submission* pointed out that money-lenders could use the exemptions in s 38 and s 630 to take control of a company without having to make a takeover bid.

225 Rosenblum *Submission* suggested that it may be desirable in certain circumstances for the market to be informed of the interests of, for example, money-lenders which could subsequently be relied on to take control of a company without making a takeover bid. By contrast, the ASC in Policy Statement 69 para 5 said that `there is no policy reason why a person in this position [having a relevant interest in shares that is disregarded under ss 38-43, but having an entitlement to those shares in the same circumstances under s 609] should be subject to ... s 709, 710 and 711 [the substantial shareholding requirements]'.

226 The ASC *Submission* argued that there should be an extension for a further week. It contended that increases in the offer price in the last week `arguably conflict with the principle that an offeree shall be given a reasonable time to consider an offer'.

227 Rosenblum *Submission* disagreed with the policy underlying the decision in *Australian Consolidated Investments Ltd v Rossington Holdings Pty Ltd* (1992) 7 ACSR 341 that clause 11 of Part A in s 750 requires detailed disclosure of the source of funds for a takeover. It considered that the `only possible relevance that such information may have [to an assessment of the merits of a takeover] is that it may indicate that the ultimate providers of the funds may not be able to honour their obligations to put the offeror in funds to enable an acquisition to proceed. .... if the offeror knows that this is the case, then the matter is one which should be disclosed in any event pursuant to clause 17 of s 750'. The Legal Committee notes that *Associated Dairies Ltd v Central Western Dairy Ltd* (1993) 11 ACSR 234 takes a narrower view of what financial information must be disclosed under cl 11. See further W Conley and D Reichel, `Takeover documentation - Is 1980s wording still good enough? - *Associated Dairies Ltd v Central Western Dairy Ltd*' [1993] *Butterworths Corporation Law Bulletin* No 21 at [391].

228 The Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs *Corporate Practices and the Rights of Shareholders* (November 1991) paras 3.3.39 and 3.3.40 referred to suggestions by the ASC that an independent expert's report should be required where

- a person concerned in the management of the target company was associated with or had a material interest in the offeror and
- shareholders are to consider transfer of a substantial interest (the Standing Committee recommended that s 623 be amended to achieve this).

Appendix 1

Respondents to Anomalies Discussion Paper

Australian Accounting Research Foundation

Australian Institute of Company Directors

Australian Securities Commission

Australian Stock Exchange

Ben Constable, Freehill Hollingdale & Page

Corrs Chambers Westgarth

Duncan Murdoch

Law Council of Australia

Rodd Levy, Freehill Hollingdale & Page

Professor Peter Little, Queensland University of Technology

Rosenblum & Partners

Securities Institute of Australia

Sly & Weigall

Peter J Watson, Sly & Weigall

Appendix 2

Provisions affected by Recommendations

Provision	Drafting requirement	Recommendation
s 9	amend definition	Rec 6
Pt 1.2 Div 5	new provision	Rec 14
s 31	new subsection	Rec 4
s 33	minor additions and deletions	Recs 1, 2 and 3
s 38	minor amendment	Rec 7
s 51	new subsection	Rec 8
s 53A	minor amendment	Rec 21
s 609	various amendments	Rec 5
s 618	replace subsections	Rec 9
s 619	minor amendment	Rec 10
s 621	minor amendment	Rec 11
s 622	repeal subsection	Rec 13
s 622A	repeal section	Rec 13
s 623	substantive amendment	Recs 15 and 16
s 625	minor amendment	Rec 17
s 627	minor amendment	Rec 18
s 629	minor amendment	Rec 19
s 630	minor amendment	Rec 7
s 635	minor amendment	Rec 22
s 636	minor amendment	Recs 23, 25 and 27
s 638	new subsection	Rec 28
s 644	minor amendment	Rec 29

s 647	minor amendment	Rec 29
s 648	minor amendment	Rec 30
s 655	new subsection	Rec 31
s 662	replacement provision and new subsection	Recs 32 and 33
s 663	replacement provisions	Recs 34 and 35
s 674	minor amendment	Rec 37
s 678	minor amendment	Rec 37
s 681	minor amendment	Rec 37
s 698	repeal of subsections and other amendments	Recs 38, 39, 40 and 41
s 699	minor amendment	Recs 24 and 42
s 728	minor amendment	Rec 44
s 730	minor amendment	Recs 44 and 45
ss 1043C, 1043D	new provision	Rec 43
-----	new provision	Rec 26
Corp Reg 6.1.01	minor amendment	Rec 46
Corp Reg Form 602A	minor amendment	Rec 47
Corp Reg	new regulation	Rec 20