LEGAL COMMITTEE OF THE

COMPANIES AND SECURITIES ADVISORY COMMITTEE

COMPULSORY ACQUISITIONS

ISSUES PAPER

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Introduction

Purpose of compulsory acquisitions

The compulsory acquisition or extinction of minority shareholdings, otherwise referred
to as minority freeze-outs, squeeze-outs or force-outs (expropriation[1]), is often a necessary and desirable means of corporate rationalisation, particularly following a successful takeover. A compulsory acquisition may produce considerable economic, administrative and taxation benefits[2] including:

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

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

Methods of compulsory acquisition

This Paper reviews the following means of compulsory acquisition or buy-outs under the Corporations Law:

- follow-on from a successful Chapter 6 bid: s 701
- acquisition of remaining shares and non-bid securities: s 703

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1 The term `expropriation' in this paper includes compulsory acquisition for value.

2 For instance, in *Elkington v Shell Australia* (1992) 10 ACSR 568 at 569-70, McLelland J stated that the policy behind compulsory acquisitions under s 701 "must be considered against the background of the economic advantages which may in broad terms be perceived as flowing from the amalgamation of business enterprises, and the financial, administrative and commercial advantages which accrue from one company becoming a wholly owned subsidiary of another". These advantages were identified by the NSW Court of Appeal in *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 587, 590. In *WCP Ltd v Gambotto* (1993) 10 ACSR 468, the NSW Court of Appeal, in the context of a compulsory acquisition through alteration to the articles of association of a company, acknowledged that full ownership would result in both "enormous taxation advantages" by permitting the transfer of tax losses between fully owned companies in a corporate group (ITAA s 80G) and "considerable administrative savings" by avoiding the company having to prepare audited group accounts. The advantages of compulsory acquisitions are also summarised in Q Digby, *Eliminating Minority Shareholdings* (1992) 10 C&SLJ 105 at 107-08, I R Renard and J G Santamaria, *Takeovers and Reconstruction in Australia* (Butterworths) at [1201], and D Grave, *Compulsory Share Acquisitions: Practical and Policy Considerations* (1994) 12 C&SLJ (forthcoming).

- share acquisitions under s 414
- selective reduction of capital: s 195
- amendment of articles or rights attached to shares: ss 176, 197, 198
- schemes of arrangement: s 411
- amalgamations: s 413
- selective share buy backs: Pt 2.4 Div 4B Subdiv J
- voluntary liquidations and selective distribution in specie: s 501
- voluntary liquidation - amalgamation: s 507
- sale of assets and liquidation.

Regulatory goals

Various proposals have been put forward to improve the regulation of compulsory acquisitions. The ASC submission to the Lavarch Committee proposed that the Corporations Law ensure that appropriate protections against compulsory acquisitions on unfair terms be consistently available for minority shareholders. The goal was to secure fairness for minority shareholders, rather than discourage compulsory acquisitions.[3]

The Lavarch Committee expressed concern that the rights of minority shareholders may not necessarily be protected in compulsory acquisitions. It adopted the ASC submission and recommended that the Advisory Committee further consider the matter.[4]

One commentator has proposed that the Corporations Law more explicitly recognise the right of a controlling shareholder to compulsorily acquire minority interests, subject to that shareholder demonstrating that

- the relevant procedural requirements were followed
- adequate disclosure was provided
- minority shareholders as a group were treated fairly.[5]

On this view, inadequate compensation to minority shareholders, rather than the compulsory acquisition itself, is objectionable. Disclosure requirements could be formulated to require the offeror to demonstrate the fairness of the force-out in return for relaxing some of the present onerous procedural requirements in some provisions.[6]

Another commentator has argued that the present compulsory acquisition rules so favour the majority shareholder that it is now "almost impossible" for a minority to resist a share expropriation. Greater prominence should be given to safeguarding minority rights.[7]

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3 Submission by the Australian Securities Commission (December 1990) at 121.

4 Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs: *Corporate Practices and the Rights of Shareholders* (November 1991) (Lavarch Committee Report) Recommendation 11.

5 Digby, supra, note 2 at 106.

6 Id, at 128-9.

7 P Spender *Compulsory Acquisition of Minority Shareholdings* (1993) 11 C&SLJ 83.

The Legal Committee considers that compulsory acquisitions are an appropriate and accepted aspect of Australian commerce notwithstanding that they override the proprietary rights of individual shareholders. The regulatory objective is to balance the interests of all shareholders, to avoid either minority oppression or dictation. In principle this requires

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

In some respects the existing compulsory acquisition provisions may be too restrictive, particularly in regard to the pre-requisites for compulsory acquisition under s 701. They could be relaxed without compromising the goals of equity and fairness.

Analysis of provisions

Follow-on from a successful Chapter 6 bid: s 701

Coverage of s 701

A bidder may employ the compulsory acquisition powers under s 701 where in consequence of a full takeover bid under Pt 6.3 or Pt 6.4 for voting or non-voting shares[8] the bidder has, during the takeover period, become entitled to not less than 90%, by value, of shares in the class to which the offer relates.[9] Where a bidder starts with an entitlement of more than 10% of the shares, then in addition to the 90% test

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

A bidder has two months from the end of the offer period to give notices in the prescribed form to the non-accepting shareholders.[10]

A notice both entitles and binds the bidder to acquire "the shares in respect of which the offers were made"[11], excluding shares to which the bidder is already entitled when the first offers were made, on the terms that were applicable under the takeover scheme. The Legal Committee has elsewhere recommended that a bidder have some discretion to settle the date which will determine the shares that may be compulsorily acquired.[12] Nevertheless, shares of the same class issued subsequent to the relevant date cannot be compulsorily acquired under s 701, notwithstanding that they may be indistinguishable from shares subject to acquisition and may be impossible to separately identify once they are traded on the ASX.[13] This restriction on later issued

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8 A bidder may use the Chapter 6 procedure to acquire non-voting shares and thereby obtain the benefits of s 701: ASC Practice Note 8.

9 A bidder who attains 90% by value but who does not wish to proceed to compulsory acquisition, or is precluded because the tests in s 701(2)(c) have not been satisfied, must nevertheless acquire any of the remaining shares, the subject of the bid, if a holder so elects: s 703(1)-(3).

10 W Kent & L Vary *Compulsory Acquisition of Shares* (1991) 9 C&SLJ 261 at 265ff raised the problem of the market not necessarily being fully informed of a bidder's intentions regarding compulsory acquisition in the period between close of the offer and the dispatch of notices to remaining shareholders. The Legal Committee considers that any such intention, once formed, would be material information under the continuous disclosure regime in the Corporate Law Reform Act 1993. Further regulation under Chapter 6 would be unnecessary.

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

12 Advisory Committee Report: *Anomalies in the Takeovers Provisions of the Corporations Law*, 1994, Rec 22-23.

13 This consequence stands oddly with the recognition in s 701(2)(b) that an offeror may proceed to compulsory acquisition where, inter alia, it has achieved the 90% threshold notwithstanding "that that number of shares may subsequently become less than that percentage as a result of the issue of further shares in that class".

shares may encourage a target company to issue them merely to thwart complete control by a bidder.[14]

Issue 1: Should shares of the same class as those for which offers were made, but issued during or after the bid, be subject to compulsory acquisition? If so, should they be counted in the 75% numerical test in s 701(2)(c)(i) (if retained)?

Shares held by any associate of the bidder at the commencement of the bid are excluded from compulsory acquisition,[15] regardless of whether

- the bidder has any real control over those shares[16]
- the association continues
- the shares are retained or sold by the associate to a third party

during the bid.[17]

Issue 2: Should shares to which an offeror is entitled at the outset of the bid be subject to compulsory acquisition under s 701?

There are various other limitations on s 701. Neither it, nor the comparable s 414, will assist a bidder to compulsorily acquire options or convertible notes or any other form of security convertible into equity. The registered holders of these securities alone can decide whether to sell them to the bidder.[18] This contrasts with the UK legislation which permits an offeror to compulsorily acquire convertible securities.[19] These issues are further discussed below.[20]

A bidder that is already entitled to more than 90% of the voting shares cannot use s 701 to acquire the balance of the voting shares by making a further bid that complies with Pt 6.3 or Pt 6.4 unless the 90% threshold requirement is modified by the Commission under s 730.[21]

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14 The right to issue shares in the offer period is subject to common law "proper purpose" rules; see Renard & Santamaria, supra, note 2 at [1148], and ASX Listing Rule 3R(3).

15 See, supra, note 11. Under s 609(1)(b), an offeror is entitled to any shares in which an associate has a relevant interest.

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

17 This consequence is also incongruous given that shares held by associates can be transferred to, and registered in the name of, the offeror during the bid for the purpose of satisfying the pre-requisites in s 701(2)(c)(ii) for the compulsory acquisition of other shares.

18 s 703.

19 UK Companies Act 1985 s 430F.

20 See Issues 23-27.

21 ASC Practice Note 8 para 4.

Issue 3: Should the legislation permit a bidder who is already entitled to more than 90% of a company's voting shares to conduct a Chapter 6 bid and exercise the compulsory acquisition powers under s 701?

Ninety per cent entitlement test

Two distinct 90% entitlement tests are possible:

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

The Australian legislation adopts the total shares test,[22] while the UK and Canada apply the outstanding shares test.[23] The latter test is more difficult to satisfy for bidders who have sizeable initial entitlements in the target company shares.[24]

Under Australian law, a bidder cannot embark on a compulsory acquisition under s 701 unless the 90% entitlement is reached during the offer period. Theoretically the ASC could grant relief from that requirement.[25] By contrast, the UK law permits a bidder who has not satisfied the 90% outstanding shares test to apply to the court for a compulsory acquisition. The bidder must establish that the shortfall in the 90% threshold consists of uncontactable shareholders and the bid consideration is fair and reasonable.[26]

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

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

24 Consider a bidder with a 60% entitlement in the target company at the outset of the bid. Under the total shares test, the bidder must acquire 30%, by value, out of those remaining 40% of shares. Under the outstanding shares test, the bidder must acquire 36%, by value, out of those 40% of shares (nine-tenths of forty per cent).

25 s 730.

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

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

The court will not make this order unless it considers that it is just and reasonable to do so, having particular regard to the number of traced shareholders who did not accept the offer: UK Companies Act 1985 s 430C(5).

The ASC has argued that, in some circumstances, an offeror could artificially rely on deemed entitlements under s 33 to help satisfy the 90% entitlement test.[27] It proposed that entitlements arising under s 33 be disregarded for the purpose of satisfying the 90% requirement.

Issue 4: Should shares in which an offeror has a deemed interest under s 33 be disregarded for the purpose of satisfying the 90% requirement in s 701(2)(b)?

Seventy-five percent in number tests

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

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

The 75% numerical tests derived from a recommendation of the UK Cohen Committee (1945).[28] Originally, the UK expropriation powers were interpreted as available only where the offeror held no more than 10% of the shares at the outset, and the scheme was approved by at least 90%, by value, of the shareholders.[29] The Cohen Committee considered it appropriate to permit compulsory acquisitions for schemes where the bidder already held more than the 10% share threshold. In this context it recommended a 75% acceptance test in addition to the existing 90% test. The recommendation was adopted.[30]

The 75% acceptance test was reviewed by the UK Jenkins Committee (1962).[31] That Committee saw "no justification" for this additional requirement and recommended its

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

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

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

30 UK Companies Act 1948 s 209.

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

repeal. A subsequent report also favoured repeal.[32] The UK legislation was amended in 1986 to abolish this test.[33] The Canadian legislation did not adopt any 75% test.

The original Australian legislation contained only an acceptance test.[34] The Edwards Committee supported its retention, subject to introducing an alternative departure test.[35]

The departure test sought to overcome acknowledged defects in applying the acceptance test, in particular uncertainty in determining the number of offerees[36] and the possibility of share splitting. However as both tests are based on numbers of shareholders without regard to the value of their shareholdings, they remain vulnerable to share splitting and other artifices by offeree shareholders and bidders.

Share splitting and other artifices by offerees. A dissident offeree may sell multiple small share parcels to its associates before or during a bid. All these persons become "offerees", thereby making satisfaction of the acceptance test more difficult. The departure test avoids the consequences of offeree share-splitting occurring after service of the Part A statement or the making of the Part C announcement.[37] The effect of earlier share splitting and registration by a dissident shareholder could be reduced by providing that the date of any public announcement of an intended bid preceding the Part A service date or the Part C announcement date shall be the relevant date under the departure test.

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

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

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

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

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

36 It may be difficult to apply the acceptance test where the number of offerees changes significantly during the offer period. Whenever shares are transferred to a third party during a takeover bid, s 649 deems the offeror to have made a corresponding offer to the transferee, who thereby becomes an offeree: s 649(c). If only part of the shareholding is transferred, a new offer is deemed to have been made to the transferor: s 649(d). Accordingly, where a significant number of on-market sales occur during the takeover, it may be difficult to ascertain whether s 701(2)(c)(i) has been satisfied. The NCSC suggested a pragmatic interpretation in Release 139.
The departure test in s 701(2)(c)(ii) is easier to administer as it is no longer necessary to determine how many "offerees" exist. The departure test simply compares the number of registered shareholders on two stipulated dates, to determine whether three quarters of the original registered holders have been removed from the register, irrespective of whether they have sold to the offeror and irrespective of what other shareholders may have been added to the register.

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

Share splitting by bidders. A bidder cannot take advantage of pre-bid share splitting under the acceptance test.[38] However, a bidder may employ share splitting to satisfy the departure test. An intending bidder could transfer numerous small target company share parcels to its associates, each of whom would become registered shareholders before commencement of the bid. These associates, by accepting the offer and being removed from the share register, would be counted towards meeting the departure test requirements. One possible response may be to disregard all shares to which a bidder is entitled at the outset of the bid for the purpose of satisfying the departure test, regardless of the actual number of registered holders of those shares. This would also address the possibility of a bidder who has acquired shares prior to the bid delaying having the share register altered until the bid is on-foot, merely to assist in satisfying the departure test.[39]

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

Non-responding shareholders. The existence of a significant number of apathetic or untraceable shareholders may also prevent satisfaction of either 75% in number test.[40] The only course open to a bidder under existing law is to seek an ASC exemption from full satisfaction of the numerical tests.

The problem of non-responding shareholders could be ameliorated by reducing the consent requirement for compulsory acquisition to, say, 50% of relevant persons. However, these shareholders could still significantly influence the offeror's ability to satisfy the procedural requirements. An alternative policy approach would be to permit compulsory acquisition once the current 90% threshold has been reached unless a certain percentage of outstanding offerees notify their dissent. This percentage could be 25% (the mirror of 75%) of outstanding offerees or even a lesser percentage, say, 20% or fewer. The legislation could require that offer documents be accompanied by a form which dissenters can complete and return to register their dissent. Two other options would be to repeal outright the 75% in number tests and retain only the existing 90% total shares test or, instead, adopt the UK and Canadian approach and replace all existing tests in s 701 with a 90% outstanding shares test, with or without a judicial discretion to permit a compulsory acquisition where any shortfall in the acceptance threshold comprises untraceable shareholders.

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

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

40 See, for instance, the facts in *TNT Ltd v NCSC* (1986) 11 ACLR 59; *Brierley v Dextran Pty Ltd* (1990) 3 ACSR 455.

Issue 5: Should the 90% total shares test in s 701(2)(b) be replaced with a 90% outstanding shares test?

Issue 6: Should the 75% in number tests in s 701(2)(c) be abolished?

Issue 7: If a number formula (in addition to a 90% entitlement test) is retained in s 701, what form should it take? For instance, should the 75% requirements be reduced? Alternatively should a stipulated number of shareholders be required to dissent from, rather than approve, a compulsory acquisition, and if so, what method for recording dissent should be adopted?

Issue 8: Should persons who buy shares in a company after a stipulated date be deemed not to be offerees for the purpose of the acceptance test in s 701(2)(c)(i) (if retained). If so, should the stipulated date be the date of any public announcement of an intending bid or the date of service of a Part A Statement or the making of a Part C Announcement, or the earlier occurring of those dates?

Issue 9: Should shares to which a bidder is entitled at the outset of the bid be disregarded for the purposes of the departure test in s 701(2)(c)(ii) (if retained)?

Issue 10: Should the relevant date under the departure test in s 701(2)(c)(ii) (if retained) be the date of any public announcement of an intended takeover bid if that occurs prior to the date of service of the Part A statement or the date of making the Part C announcement?

Issue 11: Should a bidder be permitted to seek court approval of a compulsory acquisition, notwithstanding that some aspect of the relevant test(s) in s 701 is not satisfied. Should any such right include, or be confined to, instances where the presence of untraceable shareholders prevents the fulfilment of the requisite test(s). Should any right to seek court approval substitute for, or be in addition to, the right in such cases to seek an ASC modification under s 730?

Consideration. The ASC has argued that shares may be compulsorily acquired at a price lower than that paid for other shares covered by the bid. Under either 75% test a disposal or transfer to the offeror may take place after the close of a successful bid for a higher than bid price,[41] yet will be counted for the purpose of satisfying either 75% requirement.[42] Remaining shares could be compulsorily acquired for the lower bid consideration.[43] This consequence, it has been argued, is contrary to the general policy of Chapter 6 that shareholders should be treated equally and that shares should be expropriated only on the same terms as have been accepted by most shareholders. A contrary view is that a bidder may need flexibility in the consideration offered in the post-bid period to induce sufficient acceptances to satisfy either 75% test.

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41 Section 615 does not regulate acquisitions by an offeror who is already entitled to 90% or more of the voting shares of the company. Also s 698 (the prohibition on discriminatory benefits) does not apply to the post-bid period.

42 Transactions for the purpose of satisfying s 701(2)(c)(i) (the acceptance test) may take place at any time prior to expiration of the period of two months from the end of the offer period for dispatching the compulsory acquisition notices: *Brierley v Dextran Pty Ltd* (1990) 3 ACSR 455 at 462-4. Section 701(2)(c)(ii) (the departure test) compares the pre-bid register with the register at the end of one month after the end of the offer period.

43 s 701(5).

Shareholders who have refused to accept a bid may be unlikely to accept later for a consideration no better than that offered earlier.

There are various options for dealing with this matter, should reform be appropriate, including:

- extending s 698 (the prohibition on discriminatory benefits) until the end of two months after the end of the offer period
- extending the provisions relating to increased bid consideration until the end of that two month period[44]
- excluding from either 75% calculation all post-bid transactions for a higher than bid price
- excluding from either 75% calculation all post-bid transactions for a higher than bid price, except where the greater consideration has been offered to all non-accepting shareholders.

The first and second options regulate the permissible consideration in post-bid transactions. The third and fourth options deal with the consequences, for satisfying either 75% test, of providing increased consideration in post-bid transactions. The Legal Committee considers that the third and fourth options are the less complex, though each would detract from the simplicity of the departure test.

Issue 12: Should there be legislative regulation concerning the consideration offered in post-bid transactions which may result in the compulsory acquisition of remaining shares? If so, which of the four identified options, or any other option, should be adopted? Should any exception be made for shares acquired on-market?

Rights of dissidents

Exemption from acquisition. A bidder's right to acquire outstanding shares under s 701 is subject to one or more dissenting offerees applying to the court, within one month of the expropriation notice being given, to prevent their shares being expropriated.[45] The notice cannot be dispatched before the close of the offer period notwithstanding that the acceptance pre-requisites for an unconditional offer may earlier have been fulfilled.[46] An application will not affect the entitlement or the obligation of the bidder in respect of other non-accepting shareholders' shares, though

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44 s 665, 666, 677.

45 s 701(6).

46 In *Elkington v Vockbay Pty Ltd* (1993) 10 ACSR 785 the Court ruled invalid the dispatch of compulsory acquisition notices prior to the close of the offer period arguing that "it would be inimical to [the] principles [of shareholders having full information and adequate time to make a decision] to allow the offeror, without intervention from the regulatory authority, to truncate time periods apparently set for the protection of the shareholders" (at 800). D Grave, supra note 2, argues that immediate dispatch of the notice should be permitted for unconditional bids, with dissident shareholders being protected by their rights under s 701 to request a written statement of the names and addresses of the dissenting offerees and to make a court application.

there is some doubt whether the bidder need acquire those shares until all court applications have been disposed of.[47] The UK law also provides a right for one or more dissidents to seek an exemption from acquisition for their shares.[48] Canadian law is not uniform on whether to permit these applications.[49] US short-form merger law makes no provision for dissidents to challenge the right of compulsory acquisition.[50]

Issue 13: Should an offeror under an unconditional offer be entitled to dispatch compulsory acquisition notices (and the requisite time periods for objection commence to run) once the acceptance requirements in s 701 are fulfilled even where the offer period is still open?

Issue 14: Should shareholders who do not proceed with a court application be entitled to receive the relevant offer consideration in the period prescribed under s 701(10)(a) or (b) (whichever last occurs) not that under s 701(10)(c)?

Dissenting shareholders may require particulars of all other non-accepting shareholders,[51] presumably to enable them to co-operate in resisting compulsory acquisition through joint actions and shared costs. However s 701(6), as drafted, may not fully achieve this goal.[52]

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47 D Grave, supra, note 2 points out that as disposal of the last court application under s 701(10)(c) will usually be the last event to happen, the subsection could be interpreted as indicating that those shareholders who do not make a court application may need to wait until that time before having their shares acquired. The author argues that it would be unreasonable for those shareholders who do not proceed with a court application to be denied the opportunity to receive the relevant offer consideration for their shares at the earliest possible date. He points out that considerable amounts of money could be involved and the offeror's obligation to acquire these shares is unaffected by the outcome of those court applications which do proceed.

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

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

50 The Delaware General Corporation Law s 253 empowers a parent corporation which owns at least 90% of the shares of each class of stock of a subsidiary corporation unilaterally to merge with the subsidiary and pay the subsidiary's minority shareholders cash for their shares. A merger resolution of the board of directors of the parent company is the only requirement. If the subsidiary is not wholly owned, the resolution must set out the terms and conditions of the merger, including the consideration to be offered by the surviving corporation to the minority shareholders, upon expropriation of their shares. Minority shareholders may require a court appraisal of the intrinsic worth of their shares, rather than accept the offer price. Shareholders cannot challenge the right of acquisition. In an appraisal action, "the only litigable issue is the determination of the value of the appraisal petitioners' shares on the date of the merger, the only party defendant is the surviving corporation and the only relief available is a judgment against the surviving corporation for the fair value of the dissenters' shares": *Cede & Co v Technicolor Inc* (Del. 1988).

51 s 701(9).

52 Shareholders may in effect find themselves precluded from taking joint action, depending on when they apply for a statement listing other dissenting offerees. Subsection 701(6) requires a dissident to make a court application either before the expiration of one month from when the offeror gave notice to dissenting offerees under s 701(2) [s 701(6)(a)] or before 14 days following the day that the applicant received a statement under s 701(9) [s 701(6)(b)], whichever is the latter. Assume dissident A gives notice under s 701(9) immediately after receiving the s 701(2) notice, and within a day or two receives a statement under s 701(9). The time period for dissident A to make a court application would then be determined by

Issue 15: Should s 701(6)(b) be amended to refer to the end of 14 days after the last day on which any dissenting offeree was given a statement under s 701(9)?

In determining applications by dissidents, Australian courts have adopted the principle that s 701 should not be given a narrow construction, but one which facilitates takeovers which have overwhelmingly succeeded. The ultimate test is not whether a compulsory acquisition is fair or unfair to a particular dissenting shareholder, but its fairness to the body of shareholders as a whole. In the absence of any express legislative directions the courts have developed and applied various guidelines in determining overall fairness.[53]

- The onus is on the dissenting shareholder to establish that the offer was unfair.
- The level of acceptances received from shareholders as a whole will be relevant. A very high level of acceptances from shareholders independent of the offeror prima facie suggests that the offer is fair.[54]
- It is not sufficient to establish unfairness by demonstrating merely that the offer is open to criticism or could be improved.
- In the absence of strong alternative grounds, the court should be guided by what commercial people concerned with the transaction think about the offer and should be slow to substitute its own view of the fairness of the scheme in opposition to the stand apparently taken by the majority of those who were directly involved.
- The degree of compliance with statutory formalities is a factor which could impinge on the notions of fairness.
- The court is not restricted to examining the consideration offered, but may investigate the conduct of the offeror in the period preceding the offer.

Discriminatory treatment to eliminate a minority may be permitted if there are legitimate commercial or administrative advantages to the company. These

s 701(6)(a), given that the 14 day period in s 701(6)(b) would earlier expire. By contrast, dissident B who seeks a statement under s 701(9) late in the month following the giving of the s 701(2) notice, and receives it after expiration of that month [and expiration of the period for A to make a court application under s 701(6)(a)] still has a further 14 days under s 701(6)(b) to commence proceedings.

53 *Elkington v Vockbay Pty Ltd* (1993) 10 ACSR 785 at 793-4; *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583 at 587, 590-1; Renard & Santamaria, supra, note 2 at [1209], [1210].

54 Lack of independence between the bidder and accepting shareholders may shift to the offeror the burden of proving that the bid is fair: *Re Bugle Press Ltd* [1960] 3 All ER 791; *Re Rees' Application* [1972] QWN 47. See further D Grave, supra, note 2.

"corporate benefits" may be considered by the court in assessing the overall fairness of an offer.[55]
The courts have adopted a flexible approach to determining whether the offer price is fair. They consider, but are not bound by, views expressed in any independent expert's report whether the bid price is fair and reasonable.[56] Past and present market price and net asset backing are also relevant.[57]

The courts have exercised considerable flexibility in determining whether unfairness has been established, taking into account

- any element of cheating, deception or impropriety
- any attempt by the majority shareholder to operate the company prior to the takeover bid in a way which substantially reduced the value of the minority shareholders' holding
- materially misleading statements in the offer documents which may have influenced the majority to accept, contrary to their best interests
- evidence that independent advice on which the target board based a recommendation to accept the bid was fundamentally flawed or
- evidence that the consideration offered was unfairly low.[58]

Issue 16: Are the existing judicial guidelines concerning the right of a dissident shareholder to seek exemption from a compulsory acquisition appropriate? Should any principles be set out in the legislation?

Issue 17: Is it appropriate for the onus to rest on a dissident shareholder and for the circumstances of the shareholders as a whole to be used in assessing fairness to dissidents?[59]

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55 See supra, note 2.

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

57 In *Catto v Ampol Ltd* (1989) 15 ACLR 307, Rogers AJA adopted the comments in *Kingston v Keprose Pty Ltd (No 2)* (1988) 6 ACLC 111 that in the circumstances the current stock market price was not a fair indication of value as one party had acquired nearly all the shares in the target, thereby depressing the price. Likewise, Jacobs J in *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 578 stated that "the manifest legislative purposes of fair dealing with minority interests would be defeated .... if the terms of their exit are to be dictated simply by the market place". However if the offer price exceeds the net asset backing per share, it is likely that the offer will be found to be fair. In *Elkington v Shell Australia Ltd* (1993) 11 ACSR 583, the NSW Court of Appeal considered the prices at which the shares were traded on the stock exchange up to the time when the takeover offer was announced as highly relevant to determining their value, and therefore the fairness of the offer price. The Court described the exchange market price as cogent, but not conclusive, evidence of the shares' true value. See generally HAJ Ford & RP Austin *Ford's Principles of Corporations Law* (6th ed), Butterworths, 1992, para 2060.

58 Renard & Santamaria, supra, note 2 at [1210].

59 P Spender, supra, note 7 at 99, questions this approach. The author suggests it gives too much latitude to the majority, and proposes (at 101) that the onus of proof be reversed so that the majority must prove that the acquisition is fair or that unfairness be assessed in relation to the

Appraisal rights. Under the UK legislation, a dissenting shareholder may apply to the court to vary the bidder's terms for compulsory acquisition.[60] Canadian law also permits a minority shareholder either to take the consideration offered in the bid or to seek a court determination of "fair value".[61] Canadian courts may join all dissenting shareholders and fix a fair value for their securities.[62] The court may also appoint appraisers to assist in determining a fair value.[63] US short-form merger laws contain similar appraisal rights.[64] By contrast, Australian courts appear to be limited to approving or refusing the compulsory acquisition of a dissident applicant's shares on the terms offered in the takeover bid. They may have no specific power under s 701 to substitute a fair value consideration,[65] notwithstanding that they have these appraisal powers in other contexts even for shares subject to a relevant takeover bid or scheme.[66] Also, Australian courts have no power to make orders for those non-accepting shareholdings who do not make an application.

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circumstances of the individual shareholder. D Grave, supra, note 2, points out that shareholders may have accepted for a variety of reasons, some of which may be unrelated to the fairness or otherwise of the offer.

60 The UK Companies Act 1985 s 430C(1)(b) empowers a court to "specify terms of acquisition different from those of the offer". These appraisal rights were first recommended by the Greene Committee, supra, note 29, at para 85.

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

- hindsight: whether information arising after the valuation date may be used in determining fair value
- minority discounts: whether there should be any reduction in the price attached to minority shares because they do not represent control of the corporation
- expropriation premium: whether a premium should be added to the fair value of minority shares to compensate minority shareholders who are being forcibly removed or squeezed-out from the company
- conduct of parties: whether the conduct of either the majority or the minority should affect the price
- synergistic benefits: whether or not valuation should take into account the activities in which the company will engage after the share purchase has taken place.

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

63 CBCA s 206(16); OBCA s 187(19).

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

65 *Kingston v Keprose Pty Ltd (No 2)* (1987) 12 ACLR 599 at 605: "[s701], which relates to compulsory acquisitions, seems to make the terms of the offer the only available terms on which the compulsory acquisition is to take place, to be escaped from only under [s701(6)] and only by obtaining a court order defeating compulsory acquisition itself". Contrast *Plaza Fabrics (Tauranga) Ltd v National Airlines Co Ltd* (1991) 5 NZCLC 96-486, a case on the equivalent of s 414, but which, by comparing the equivalent of s 701 and s 703, argued that a court, under s 414 at least, is not restricted to merely approving or prohibiting a disputed acquisition, but may impose terms. D Grave, supra note 2, also questions whether the court has power under s 701(6) to vary the terms of the acquisition. Renard & Santamaria, supra, note 2 at [1211] suggest that the court may have an inherent or implied power under s 701(6) to award interest on the consideration payable under an offer to a dissenting offeree.

66 This produces the apparent paradox that a court may settle terms when an acquisition is initiated by the shareholder (ss 414(9), 703(3)) but not when it is initiated by the offeror (s 701). In the

Issue 18: Should a shareholder be entitled to seek a variation of the terms of an acquisition (appraisal rights)? If so

(a) should a court or an administrative body (for instance experts appointed by the ASC) conduct the appraisal

(b) what, if any, specific powers or directions should be set out in the legislation?

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

Costs orders. Under the UK legislation no costs order may be made against a dissenting applicant shareholder unless the court considers that the application was unnecessary, improper or vexatious or that the applicant is otherwise acting unreasonably.[67] Canadian law provides that shareholders exercising their appraisal rights are not required to give any security for costs in an application.[68] The US short-form merger laws empower the court to order that expenses incurred by any applicant shareholder may be charged against the shares entitled to be appraised.[69] There are no specific costs powers in s 701 though the courts, on occasion, have varied the usual rule in civil litigation that costs must be borne by the unsuccessful party.[70]

Issue 19: Should there be specific provisions dealing with cost orders? If so, what principles should apply?

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latter, but not the former, situation the terms are confined to those in the takeover bid. The appraisal powers in s 703 were applied in *Kingston v Keprose Pty Ltd* (1987) 12 ACLR 599 and *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd* (1990) 1 ACSR 569: see post note 75.

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

68 CBCA s 206(13); OBCA s 187(16).

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

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

Acquisition of remaining shares and non-bid securities: s 703

Holders of shares not accepted under a formal bid (remaining shares[71]) and holders of non-voting shares, renounceable options and convertible notes (non-bid securities) may require their purchase by a bidder who becomes entitled to not less than 90% of the voting shares of the relevant class (for remaining shares) or 90% of all voting shares (for non-bid securities), during the takeover period. The bidder is obliged to give a notice of entitlement within one month after the close of the offer period.[72] A bidder who proposes terms for acquisition of non-bid securities in the s 703(4) notice must include an independent expert's report on whether those terms are fair and reasonable.[73] Possibly, this obligation could be avoided by not proposing terms in the s 703(4) notice.[74] An intending vendor may apply to the court for alternative terms of acquisition.[75]

Issue 20: Should an offeror, or any associate of the offeror, who proposes to acquire non-bid securities where the pre-requisites in s 703(4) have been satisfied, be required to accompany the proposal with an independent expert's report, where the proposed terms of acquisition are not set out in the s 703(4) notice?

There are various limitations in s 703. Holders of shares that are of the same class as `remaining shares' but are issued after the commencement of the bid cannot require their acquisition under this provision.[76] Holders of voting shares not included in the class of shares to which the bid related, also fall outside s 703.

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71 The term `remaining shares' as used in s 703(1)-(2) is not defined.

72 s 703(1), (4).

73 s 703(5)-(7); ASC Policy Statement 75 & ASC Practice Note 42.

74 In *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 577, Jacobs J questioned whether the obligation could be avoided, at least where a later offer to acquire these securities was made by an "alter ego" of the original bidder.

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

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

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

76 Subsection 703(1) refers to notices being given to holders of remaining shares in the class that had not received compulsory acquisition notices under s 701(2). Subsection 701(2) notices cannot be given for these later issued shares: see, supra, Issue 1.

Issue 21: Should holders of shares in the same class as "remaining shares" but issued after offers were made, be entitled to require their acquisition in the same manner as holders of remaining shares?

Issue 22: Should all holders of voting shares not included in the class of shares to which a bid related or particular holders of voting shares (for instance employees holding voting shares under an employee share scheme) be entitled to require their acquisition under s 703?

There is no power under s 701 or s 703 for the bidder to compulsorily acquire non-bid securities, other than non-voting shares made subject to a bid,[77] nor does the ASC have the power to permit this for securities other than voting or non-voting shares.[78] This contrasts with the UK legislation which permits an offeror to compulsorily acquire convertible securities.[79]

The Edwards Committee stated that evidence given to it suggested that an offeror should be able to compulsorily acquire renounceable options and convertible notes.[80] It proposed that this question be further examined by the Advisory Committee.[81]

The Legal Committee notes that the inability of a bidder to use the compulsory acquisition procedure under s 701 to acquire outstanding renounceable options and convertible notes creates opportunities for additional takeover defences.[82] Also, the desire to acquire these securities may require that particular takeovers be implemented under Chapter 5, rather than Chapter 6, or that other procedures be adopted.[83]

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77 Non-voting shares can be made subject to a Chapter 6 offer: ASC Practice Note 8. Also, as Renard & Santamaria point out, supra, note 2 at [1215], it would theoretically be possible for the ASC to exercise its powers under s 730 to permit compulsory acquisition of non-voting shares under s 701, based, for instance, on the success of any prior takeover bid for the voting shares.

78 In *ANZ Executors & Trustees Ltd v Humes Ltd* (1989) 15 ACLR 392, a company requested the NCSC to exercise its discretion under the equivalent of s 730 to enable it to compulsorily acquire convertible notes. The court ruled (at 414) that the Commission did not have the power to modify the equivalent of s 703 in the way requested. Renard & Santamaria, supra note 2, at [1215] also point out that the various matters in s 731 that the ASC must take into account for the purposes of s 728 or s 730 only relate to issued voting or non-voting shares.

79 UK Companies Act 1985 s 430F.

80 *Report of the Joint Select Committee on Corporations Legislation* (April 1989), para 13.48.

81 Para 13.49.

82 A company could issue convertible notes to persons friendly to the board, with the right to convert in consequence of any unconditional takeover bid being made for the company: N O'Bryan, *Takeover Offers and Prospectus Requirements under the Companies Code* (1985) 3 C&SLJ 3 at 5-6.

83 Another means to acquire convertible notes is to amend the convertible note deed, by resolution of noteholders, to accelerate the redemption date: *Re TMOC Resources Ltd* (1989) 15 ACLR 368; *ANZ Executors & Trustees Co Ltd v Humes Ltd* (1989) 15 ACLR 392. The deed may impose voting restrictions on interested parties and require a special majority. This procedure is not available for options which, instead, may be compulsorily acquired under a s 411 scheme of arrangement.

Issue 23: Should a bidder be empowered to compulsorily acquire renounceable options, convertible notes and non-voting shares? If so, which of the following, or other, policy options should be adopted:

(a) permit a bidder to compulsorily acquire all these securities if the bidder satisfies the s 701 requirements (as they may be amended) for compulsory acquisition of remaining voting shares

(b) the same as (a), except that the bidder must satisfy the s 701 requirements (as they may be amended) on the basis of the company's fully diluted share capital, ie taking into account any non-voting shares and on the assumption that all options have been exercised and all convertible notes have been converted, for the purpose of determining the total shareholding of the company

(c) introduce in s 703 the equivalent numerical tests as in s 701, namely, that a bidder should be entitled to compulsorily acquire the remaining options/convertible notes if the equivalent percentage(s) of the outstanding option holders/note holders agree (compare Issues 5-11)?

Issue 24: Should the ASC have a discretionary power to relieve bidders of full compliance with the adopted test(s)?

Issue 25: Should the discretionary powers of the ASC under ss 728 and 730 be extended to securities other than shares?

Holders of non-renounceable options cannot request their acquisition under s 703.[84] The Legal Committee raises for consideration whether the provision should be amended to permit or require a successful bidder to acquire these otherwise non-transferable securities.

Issue 26: Should holders of non-renounceable options be given the same powers as holders of renounceable options to require acquisition by the bidder?

Issue 27: Should a bidder be empowered to compulsorily acquire non-renounceable options? If so, which of the policy options outlined in Issue 23 should apply?

Another limitation of s 703 is that, in general, only those holders of non-bid securities who are registered as holders at the time of service of the s 703(4) notice, and remain registered, may give notice under s 703(8) requiring that these securities be acquired.[85] A purchaser of non-bid securities during or after a takeover bid can retain

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

85 *Kingston v Keprose Pty Ltd (No 3)* (1987) 12 ACLR 609. According to Hope JA: "If a person buys options at a time when he knew he may be locked in if a current takeover bid is successful, there seems to be no reason why the legislation should protect him against a difficulty [lack of rights under s 703], the risk of which he knowingly accepted and against which, as I will suggest, he could have protected himself by contract" (at 619). A possible exception may be securities "subject to transmission on death or possibly other events" (at 620). A possible "other event" is where the beneficial holder is entitled to be registered long before the takeover scheme

the benefit of s 703 only through contractual arrangements with the registered vendor.[86]

Issue 28: Should persons who are entitled to be registered as holders of non-bid securities at the time of service of the s 703(4) notice, whether or not they later become registered, be entitled to invoke the acquisition rights under s 703(8)?

Share acquisitions under s 414

Current law

Minority shareholdings subject to a scheme regulated by s 414 may be compulsorily acquired, or alternatively the minority shareholders may require their acquisition. This section is the counterpart of ss 701 and 703 where a formal takeover bid under Chapter 6 is either not required or is not possible without modification. It may be used, for instance, where

- the bid is for a company with 15 or fewer members[87]
- a bid is for a class of non-voting shares[88] or
- a bid is made by an offeror who is already entitled to 90% or more of the target's voting shares.[89]

Like s 701, the section has no application to options and convertible securities.

There is no restriction in s 414 on schemes that are proposed to enable a person to avoid Chapter 6.[90] However the restrictions in s 615 apply to transactions under s 414.[91]

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was announced: *Mercantile Mutual Life Insurance Co Ltd v Actraint No 85 Pty Ltd (No 2)* (1990) 1 ACSR 569 at 586-87. D Grave, supra note 2, argues that from a policy viewpoint it is difficult to justify a situation where persons who obtain a right to become registered as holders prior to dispatch of a s 703(4) notice, or only obtain such a right after the dispatch of the s 703(4) notice, are precluded from requiring the offeror to proceed with the acquisition under s 703(8).

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

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

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

89 Renard & Santamaria, supra, note 2 at [1216] Antn 10, give the example of a bidder who owns only a small number of target shares but is "entitled" to all the issued target shares due to pre-emptive rights in the company's articles of association: *North Sydney Brick & Tile Co Ltd v Darvall* (1986) 10 ACLR 837. An ASC modification of s 701(2)(b) would be required to permit the bid to proceed under s 701: ASC Practice Note 8.

90 Contrast s 411(17).

A scheme or contract involving a transfer of shares must be approved by the holders of at least 90%, in nominal value, of the relevant class, excluding the offeror's shares or those of its nominee or subsidiary (the outstanding shares test).[92] Also, where the offeror, or its nominee or subsidiary, initially holds more than one-tenth of the aggregate nominal value of the issued shares in the relevant class, acceptances must be received from not less than three quarters in number of the holders of shares in the class, again excluding the offeror, its nominees and subsidiaries.[93]

A s 414 scheme or contract requires neither court approval nor a meeting of shareholders. Also, unlike s 411 or s 701 schemes, there are no statutory disclosure requirements. Accordingly, the content of the offers can be minimal, subject to compliance, for instance, with s 995 or s 999 which prohibit misleading or deceptive conduct or statements in connection with the offers.

Issue 29: Should companies be obliged to give notice to the ASC of their intention to enter into a s 414 scheme?

Issue 30: Should s 414 contain specific minimum disclosure requirements for shareholders?

Upon obtaining the necessary acceptances, the offeror may give notice of compulsory acquisition to any non-accepting shareholders. That notice both entitles and binds the offeror to acquire the dissenting shareholders' shares on the terms approved by the 90% majority unless the court orders otherwise on application by a dissenting shareholder.[94] As with s 701, the court may exempt an applicant's shares from compulsory acquisition. There is some doubt whether, alternatively, the court can impose different expropriation terms.[95]

Issue 31: Should specific provision be made for appraisal rights for dissident shareholders in s 414 schemes. If so, what form should they take, and what, if any, provision for cost orders should be made [compare Issues 18, 19]?

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

92 s 414(2).

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

94 s 414(2), (3).

95 Contrast the limited powers of s 414(3), that is, a compulsory acquisition on the terms approved by the 90% majority shall go ahead "unless the court orders otherwise", with the specific judicial appraisal powers in s 414(10)(b), which provides that a transferee may be bound to acquire shares "on such other terms ..... as the Court ...... thinks fit to order". The latter provision covers the circumstances where a transferee under a scheme or contract becomes beneficially entitled to 90% of the shares of a class, but elects not to issue a compulsory acquisition notice under s 414(2). In that case a minority shareholder may give notice requiring that the transferee acquire the shares: s 414(9) (cf s 703(1)-(3)). Renard & Santamaria, supra, note 2 at [1217] refer to case law both supporting and opposing the proposition that the court has power to alter the consideration payable under the offer. In any event, it is clear that the court can award interest in appropriate circumstances.

Law reform proposals

The ASC submission to the Lavarch Committee expressed concern about the ease of circumventing the numerical requirements in s 414(5). It argued that the definition of "excluded shares" in s 414(1) is so antiquated that it can be avoided by an intending offeror who holds at least 90% of the shares transferring them to a "related company" that is not a nominee or direct subsidiary. The transferee company can then, by accepting the offer, grant the necessary 90% approval even though it is owned by the same holding company as the offeror. This arrangement also circumvents the 75% in number requirement as the offeror then holds less than 10% of the excluded shares. This has enabled a number of offerors who were unable to satisfy the tests in s 701(2) to resort to s 414 to eliminate minority shareholdings.[96] The ASC argued that the definition of "excluded shares" in s 414 should be replaced with a reference to "shares to which the offeror is entitled" within the meaning of s 609, thereby attracting the broad definitions of "relevant interest" and "associate" in the legislation. This would capture artificial devices and avoid having to prove that the related non-subsidiary was the nominee of the offeror.

The Lavarch Committee recommended that the right of compulsory acquisition in s 414 not be available unless the thresholds and their calculations are determined in the same manner as under s 701.[97]

The Legal Committee notes that s 414(5) currently employs the more onerous 90% of outstanding shares test, rather than the 90% of total shares test, as found in s 701.[98] To adopt the ASC submission, without amendment, could result in s 414 being significantly more difficult to satisfy than s 701. The Legal Committee considers that procedural uniformity between these sections is necessary, in regard to both the appropriate 90% test and the 75% in number test, if retained. Section 414(5) would need to be amended accordingly.

Issue 32: Should the relevant test for the 90% threshold in s 414 be changed from the outstanding shares test to a total shares test [compare Issue 5]?

Issue 33: Should the 75% in number requirement in s 414 be abolished [compare Issue 6]?

96 ASC Submission to the Lavarch Committee at 119. Digby, supra, note 2 at 111-12 refers to a similar device under s 414 to overcome the 75% in number requirement where, following a formal takeover scheme, a bidder is entitled to more than 90% of the issued voting shares of the target but cannot satisfy the 75% in number test. The device involves the bidder incorporating a special purpose subsidiary, which, being an "associate" of the bidder, is already "entitled" for the purposes of Chapter 6 to the bidder's shares in the target. Accordingly, the subsidiary is able to acquire further shares in the target company without contravening s 615. However, given the limited definition of excluded shares in s 414(1), the subsidiary will not itself hold any shares in the target company and will not be required to satisfy the 75% in number requirement in s 414(5). It can thus make offers to acquire all the shares in the target company, assured of gaining approval from its parent company to satisfy the 90% approval requirement in s 414. The author notes that the legality of this arrangement remains in doubt.

97 Recommendation 10.

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

Issue 34: Should s 414 be amended to substitute the term "shares to which the offeror is entitled" for the phrase "excluded shares" as it appears in this section?

Issue 35: Should the ASC be given a discretionary power to relieve an applicant from compliance with the relevant percentage test(s) in s 414?

Selective reduction of capital: s 195

A company, if authorised by its articles, may reduce its share capital by special resolution and court confirmation. A reduction may involve a selective retirement of equity in return for cash or some other consideration.[99] The s 195 procedure will not apply where the arrangement does not involve any real reduction of capital.[100] However, a selective capital reduction arrangement will not be struck down merely because it seeks to overcome a difficulty with proceeding under a Chapter 6 takeover bid.[101] Any resolution to reduce share capital must be unambiguous and indicate specifically the intended new share capital.[102] Minorities may be protected against expropriation of their shares by suitably drafted memorandum or articles.[103]

The court has a broad discretion under s 195, which includes protecting minorities in compulsory acquisitions. The court must determine

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99 See, for instance, *Ramsay Health Care Ltd v Elkington* (1992) 7 ACSR 73.

100 In *Re Hunter Resources Ltd* (1992) 7 ACSR 436, the court refused to confirm a selective cancellation of capital whereby its shareholders, other than its immediate parent, would receive shares in its ultimate holding company. The court ruled that the company was not financing the reduction from its own resources. The arrangement "was in essence a reorganisation of the share structure of the company that has only a superficial resemblance to a reduction of capital by cancellation of ordinary shares".

101 In *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 the court confirmed a proposed reduction to cancel the shares of all shareholders, other than the two majority shareholders, in return for a cash consideration. The defendants, who held approximately 0.5% of the shares to be cancelled, objected to the proposed reduction. The majority shareholders did not follow the Chapter 6 procedure as it was unlikely that the requirement in s 701(2)(c) for approval by 75% of the outstanding shareholders in number could be met, given that there was a large number of untraceable shareholders. Bryson J considered whether the outcome would have been different for minority shareholders under Chapter 6. His Honour, in not requiring that the Chapter 6 procedure be followed, stated that "if the fair money equivalent of their shares or more is available to [the expropriated shareholder] it is not in my judgment unfair or inequitable to minority shareholders that [the majority shareholder] has not been required to go about a more elaborate and less certain procedural course [under Chapter 6] before the objectors are required to part with their shares and accept that compensation" (at 236). The majority shareholders did not vote at the meeting which overwhelmingly supported the reduction pursuant to s 195. An independent expert's report on whether the proposal was fair and reasonable was made available to shareholders.

102 *Re Cracow Resources Ltd* (1993) 10 ACSR 749.

103 A share cancellation, even if selective, does not amount per se to a variation of rights under s 197 or s 198: *Re Saltdean Estate Co Ltd* [1968] 3 All ER 829; *House of Fraser plc v ACGE Investments Ltd* [1987] 2 WLR 1083 at 1088-90. However, classes of shareholders can be protected by an express clause in the memorandum or articles (constituent documents) of the company that a reduction of capital which affects their shares is to be treated as a variation of class rights subject to s 197 or s 198. The articles could then provide a particular procedure for variation or abrogation of those rights, or could declare those rights to be unalterable. The clause in the constituent documents would itself have to be entrenched.

- whether the resolution was duly passed at a properly convened and informed meeting
- whether creditors are prejudiced[104]
- whether the reduction is fair as between the members whose shares are being cancelled and the remaining shareholder(s).[105]

In determining fairness, the courts will look primarily to the minority shareholders' economic interests.[106] For instance, an arrangement that fails to include a cash alternative for expropriated shareholders may not be a fair cancellation.[107]

A court will not refuse a capital reduction merely to precipitate action under Chapter 6. However it will consider what the position of the minority shareholders would be if the Chapter 6 procedure had been followed. A reduction may be fair and not oppressive if it is unlikely that the minority shareholders would have achieved a significantly better result under Chapter 6.[108] Conversely, a reduction may be refused if it is unfair to a group of shareholders or there has been insufficient disclosure, including details of any benefits to be derived by particular persons from the reduction.[109]

There is no statutory obligation to notify the ASC of the capital reduction proposal. However prior notification is expected, given that the Commission may intervene under s 1330 in any court proceedings involving a selective capital reduction.[110]

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104 Any reduction of capital under s 195 must adequately protect creditors. The procedure for notifying them and obtaining their approval or otherwise protecting their interests is set out in s 195(3)-(5), (10). Digby, supra, note 2 at 115 points out that in a proposal to eliminate minority shareholdings, funds to protect creditors may be provided by the majority shareholder financing the reduction either through a subscription for new shares or by a subordinated loan or a gift to the company.

105 In *Ramsay Health Care Ltd v Elkington* (1992) 7 ACSR 73 at 77-8, the Court saw its task as "essentially, to ensure that [the] decision was taken validly, that the members were fully informed and that the resolution is not prejudicial to some class of members. It is not for the court to determine the merits of the reduction except in that context".

106 According to Bryson J in *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 at 244: "Once it is accepted, as I must accept because judges have accepted it for about a century, that an arrangement like this is a reduction of capital and that a shareholder who is given the fair money equivalent of his shares is dealt with fairly, and that no great weight is attributed to the wish of a shareholder to go on owning the shares which he has bargained to have" the reduction should be upheld.

107 *In Hunter Resources Ltd* (1992) 7 ACSR 436, the Federal Court held that an offer which included no alternative to receiving securities in another company was unfair. By contrast in *Re Stockbridge Ltd* (1993) 9 ACSR 637, the Court ruled that an offer which provided a cash alternative to securities in the offeror gave a fair choice to those shareholders who did not wish to become members of the bidder.

108 In *Catto v Ampol Ltd* (1989) 15 ACLR 307 the New South Wales Court of Appeal applied the general principles in s 731 in exercising its discretion to approve a reduction of capital under s 195, in particular, that the person seeking to gain absolute control of a class of shares should ordinarily "as a matter of fairness, give all members of that class the opportunity of sharing equally whatever premium the rights attached to that particular class of shares brings into existence" (at 310).

109 *Re Campaign Holdings Ltd* (1989) 15 ACLR 762. Listed companies must also comply with the Australian Stock Exchange (ASX) Listing Rule 3J(32)(c) which provides for equality of treatment for fully and partly paid shares in any corporate reconstruction.

110 ASC Practice Note 29, para 43, 44:

Issue 36: Should s 195 specifically require companies to give notice to the ASC of their intention to undertake a share reduction?

ASC Practice Note 29 indicates that the Commission will examine selective capital reduction proposals with a view to ensuring that

- they are consistent with an efficient, competitive and informed market
- all material information is provided to shareholders, including adequate disclosure of material interests and
- a fair and equitable balance is struck between shareholders leaving and those remaining in the company.

In considering fair treatment, the ASC will be guided by the statements of principle in s 731 dealing with the takeover of a company and the rights of minority shareholdings. The ASC points out that the mere fact that the minority shareholders may effectively be removed from the company, regardless of whether a particular affected minority shareholder voted in favour of the special resolution, does not mean that the proposal is necessarily unfair to minority shareholders as a group. Two matters which affect fairness are the level of disclosure and the voting procedures for the resolution to reduce the share capital.

Section 195 prescribes no specific disclosure obligations. However the ASC Practice Note points to judicial authority that the directors are under a duty to ensure that any notice of meeting fairly informs shareholders of the proper business of the meeting and is not misleading. Companies must disclose[111]

- all the information reasonably necessary to enable shareholders to make an informed decision
- a reasonable description of the proposal and
- all of the material reasons for the proposal.

The ASC will be guided by the disclosure regimes in Chapter 6 and Pt 5.1 and will expect the explanatory memorandum to set out the specified information required under these provisions to the extent that they are relevant to a selective capital reduction.

The ASC Practice Note 29 also sets out the Commission's view on the necessary disclosure content of a notice of meeting, including an explanatory memorandum and

- "If a company proposing a selective capital reduction gives a copy of the notice of meeting to the ASC at the same time as it gives it to shareholders, it will increase the probability that the ASC will decide whether the proposal (and the procedure) is fair by the time the company makes the application for confirmation.
- It is an inappropriate waste of the company's, the Court's and the ASC's time for matters which might have been resolved earlier with sufficient notice to the ASC, to be resolved by the ASC's intervention in the Court".

111 ASC Practice Note 29, para 20.

details of any selective benefits arising from the capital reduction. The memorandum must include a statement of directors' interests in the capital reduction and their recommendations, and how they intend to vote, on the proposal. Although an independent expert's report is not specifically required by legislation, the ASC considers that one should usually accompany the explanatory memorandum to satisfy the information requirements of fairness, given that directors of the company will frequently be interested persons. The report should state whether, in the opinion of the expert, the proposal is fair and reasonable in striking a fair balance between the interests of the expropriated and the continuing shareholders. The principles governing these experts' reports should be the same as those applicable to other experts' reports under the Corporations Law, particularly those required by Chapter 6. The ASC will examine a proposal more carefully where an independent expert's report is not provided. The information given must enable affected shareholders to make a properly informed decision.

Issue 37: Should s 195 set out more specific disclosure requirements for share reductions involving expropriations and, if so, what should the requirements be?

Section 195 does not expressly require class meetings or the disenfranchisement of a member whose shares will not be cancelled. However, ASC Practice Note 29 states that such shareholders and their associates should abstain from voting or, less desirably, the company should segregate their votes to provide evidence that the minority shareholders have approved the reduction. There are judicial recommendations to the same effect.[112]

The ASC Practice Note also proposes that there be a statement in the explanatory memorandum indicating that the courts will consider the views and votes of expropriated shareholders as most important when deciding whether to confirm a capital reduction. This will ensure that shareholders who are to be expropriated are aware of the primacy of their views and votes.

Issue 38: Should s 195 specifically exclude voting by persons whose shares will not be expropriated, rather than rely on judicial or ASC recommendations concerning non-voting or segregation of voting?

Amendment of articles or rights attached to shares: ss 176, 197, 198

Shareholders may, by special resolution, insert or amend articles (s 176) or vary or abrogate non-entrenched rights attaching to shares or a class of shares (ss 197, 198) to

112 *Re Campaign Holdings* (1989) 15 ACLR 762 at 767; *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 at 237-38.

authorise a compulsory acquisition.[113] There are no statutory voting exclusions. A variation or abrogation is not subject to the court's confirmation.

Minority shareholders have certain protections.

- The constituent documents may provide for a different variation or abrogation procedure or declare certain rights to be unalterable.[114]
- A dissident shareholder may challenge a resolution for expropriation as being a fraud on the minority or otherwise oppressive.
- The holders of more than 10% of the issued shares, or of those of the relevant class, may apply to the court to have the variation set aside.[115]

In a minority shareholder application, the court may uphold a change to the constituent documents to permit the expropriation of shares if it is satisfied that this has legitimate commercial ends, adequate compensation is provided and the compulsory acquisition would not otherwise unfairly prejudice the shareholders generally or the members of the applicant's class.[116] Some commentators has questioned whether these principles unduly favour the interests of the majority over the minority.[117]

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113 An article could, for instance, permit the directors or general meeting to compel shareholders to transfer their shares to a designated member or, alternatively, authorise the company to sell the shares: *Palazzo Corporation Pty Ltd v Hooper Bailie Industries Ltd* (1988) 14 ACLR 684. In *WCP Ltd v Gambotto* (1993) 10 ACSR 468, a special resolution was passed providing for the insertion of a new article empowering any shareholder with 90% or more of the shares to compulsorily acquire the remainder at a stipulated price. The notice of meeting was accompanied by an independent expert's report valuing the shares at less than the stipulated acquisition price. The majority shareholder did not vote on the special resolution. The NSW Court of Appeal held that the powers in s 411, 414, 701-2 are not an exhaustive code governing the expropriation of shares. This end may also be achieved through new or amended articles of association. In the present case there were substantial taxation and administrative benefits for the company if the expropriation went ahead. Also, there was no allegation that the compensation for the expropriation was inadequate. In these circumstances the new article was upheld as it did not constitute a fraud on the minority or otherwise amount to unjust oppression. The Court of Appeal stated, however, that a proposed amendment would be ex facie invalid if it involved expropriating shares without compensation or at an undervalue. The Court of Appeal decision overruled the conclusion in the first instance judgment that an expropriation article, per se, "amounts to unjust oppression of those minority shareholders who object" and that "if a majority holding or controlling 75% or more of the issued capital of a company could validly expropriate the shares of a minority by an alteration to the articles for the reasons of the kind advanced in this case, it would be unnecessary to have such provisions for compulsory acquisition of shares of dissenting minorities as are to be found in ss 414 and 701 of the Corporations Law": *Gambotto v WCP Ltd* (1992) 8 ACSR 141 at 144-45. The New South Wales Court of Appeal also rejected the submission that an article which permits the expropriation of minority shares constitutes a restriction on their transferability in breach of s 180(3)(c). Minority shareholders could transfer their shares until they received an expropriation notice.

114 s 197(2), (3); s 198(2), (3). See also, supra, note 103.

115 s 197(4)-(6); s 198(4)-(6).

116 See, supra, note 113.

117 K Yeung in "*WCP Ltd v Gambotto*" (1993) 11 C&SLJ 323-7, argues that "the danger lies in the extent to which [*WCP Ltd v Gambotto*] implies that an expropriation by the majority will always be legitimate where the majority offers to pay an amount equal to, or in excess of, the

The ASC submission to the Lavarch Committee argued that the Commission should be given prior notification of any proposal to introduce an expropriation power into a company's constituent documents. The Commission also proposed that it have power to require that shareholders be provided with an independent expert's report before voting on the proposal.

Issue 39: Should there be further legislative restriction on altering a company's constituent documents, or rights attached to shares, to authorise compulsory acquisitions?

Issue 40: Should the legislation require prior notification to the ASC of any proposal to introduce a compulsory acquisition power in a company's constituent documents, and, if so, should any consequential powers be available to the Commission?

Issue 41: Should there be more specific disclosure requirements for alterations that may involve compulsory acquisitions, for instance, an independent expert's report?

Issue 42: should there be a statutory prohibition on persons whose shares are not to be expropriated voting on a resolution to amend the constituent documents to permit compulsory acquisition?

Issue 43: Should the court have further powers, for instance, to substitute a fair expropriation price or other terms, in lieu of having the variation set aside?

Schemes of arrangement: s 411

Outline

A scheme of arrangement may involve minority shares or other securities being extinguished in exchange for the issue of securities in another entity (usually shares, notes or options in the offeror) or for a cash consideration.[118] Any scheme involving a cancellation of shares must also comply with s 195.[119]

The procedures for a s 411 scheme involve extensive statutory disclosure requirements, advance notification to the ASC and court supervision from the outset. They may be compared with other compulsory acquisition procedures.

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market value of the shares"; V Mitchell "*Gambotto and the Rights of Minority Shareholders"* National Corporate Law Teachers Conference, February 1994.

118 S. Traves, *A Scheme of Arrangement can be an effective method of takeover* (1994) 12 C&SLJ 32 at 44-5 describes a scheme of arrangement which results in a transfer of control as commonly taking the following form:

- all the share in the target company, other than those held by the bid company, are cancelled
- the reserve thus created is utilised for the issuing of further paid-up shares in the target company to the bid company
- shares in the bid company are issued to the shareholders in the target company as compensation for the cancellation of their shares

119 Subsection 195(15) only exempts reductions of capital under Chapter 6.

- The Court must approve an explanatory statement under s 412.[120] The purpose of the statement is to inform the members about the purpose and likely effect of the proposed scheme and any material interests of directors. An independent expert's report may also be required.[121] This contrasts with s 414, for instance, which has no statutory disclosure requirements.

- Where more than one class of members is involved, separate meetings must be held and separate approvals obtained. The concept of "class of members" in s 411 is not defined in the legislation, but is left to common law principles.[122] Persons whose shares will be expropriated may form a different class from remaining shareholders. By contrast, segregation into classes is not a stipulated requirement for a selective capital reduction under s 195.

- The requisite majorities under s 411 are 75% in value and a simple majority in number of those present and voting in person or by proxy at each class meeting. These majorities may be easier to attain than 90% by value and, usually, 75% in number of all outstanding offerees, required under s 414 and s 701.

- Subsection 411(17) provides that the court shall not approve a s 411 compromise or arrangement unless it is satisfied that the scheme has not been proposed to enable a person to avoid Chapter 6 or unless the ASC has issued a written statement that it has no objection. There is no equivalent provision in other compulsory acquisition procedures.

The court may not authorise an arrangement which is inconsistent with the Corporations Law or which has as a `substantial purpose' to avoid the operation of Chapter 6.[123] Subject to that, there is no assumption that the takeover provisions in Chapter 6 should be preferred to the scheme provisions of Chapter 5, nor will a scheme be disapproved merely because it displays some characteristics of a

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

[121] See ASC Policy Statement 75 para 8.

[122] In *Re Stockbridge Ltd* (1993) 9 ACSR 637, the Court confirmed that in the context of schemes of arrangement, it is proper to treat option holders as creditors rather than as members. See also *Re Austamax Resources Ltd* (1985) 10 ACLR 194; *Re BDC Investments Ltd* (1988) 13 ACLR 201; *Re US Masters Ltd* (1991) 4 ACSR 462. Under general common law principles a convertible noteholder would be a creditor for the purposes of s 411. See also ASC Practice Note 32.

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

takeover.[124] Rather a court will consider the Chapter 5 and Chapter 6 provisions together, and subject to the same principles of full disclosure and fairness to shareholders.[125] A court is not bound to approve a scheme simply because it earlier granted leave to convene the meetings or because requisite majorities of members or creditors agreed to it.[126] Dissenting members or creditors may make submissions opposing the approval on grounds which may include new material not available to the court when leave to convene the meeting was granted.[127]

ASC policy

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

- compulsory acquisitions by a majority shareholder who is already entitled to more than 90% of the voting share capital[128]
- compulsory acquisitions of options and convertible securities (sometimes simultaneously with shares)[129]
- schemes that require a reduction of capital by the target company[130]
- acquisitions of more than one class of share or security.[131]

The ASC Policy Statement sets out detailed guidelines for the conduct of shareholders' meetings, including the information to be provided to members,[132] the terms of resolutions where there are separate classes of members, and the principles for determining the fairness of any differences in consideration offered for each class of share or other security. The ASC will look to the disclosure requirements in Pt A

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

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

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

127 Id.

128 An ASC modification of s 701(2)(b) would be required to permit this to proceed under Chapter 6: ASC Practice Note 8.

129 *Re Stockbridge Ltd,* (1993) 9 ACSR 637. Renard & Santamaria, supra, note 2, para [1215] & [1515] refer to some uncertainty in the case law about whether renounceable options fall within s 411, and a lack of any High Court opinion on the matter.

130 *Re ACM Gold Ltd* (1992) 7 ACSR 231 at 239-40*: Re Stockbridge Ltd* (1993) 9 ACSR 637.

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

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

of s 750 and the principles in s 731 when considering the level of disclosure under any scheme of arrangement which is capable, in whole or part, of being effected as a takeover scheme.

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

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

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

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

- it has no concerns regarding the disclosure of all material information
- the treatment of members is consistent with the Eggleston principles (s 731) and
- there has been proper compliance with the procedures for the conduct of meetings.

Issue 44: Should s 411 be amended to place beyond doubt that it applies to compulsory acquisitions of both renounceable and non-renounceable options as well as convertible notes and shares?[133]

Issue 45: Should persons whose shares or other securities are not to be cancelled be expressly excluded from voting in a compulsory acquisition scheme of arrangement?

Issue 46: Should the requisite majorities in s 411, namely 75% in value and 50% in number of those present and voting, be altered for a scheme involving a compulsory acquisition of securities?

Issue 47: Should schemes of arrangement involving the cancellation of shares be exempt from the additional requirements of s 195?

133 See, supra, note 129.

Amalgamations: s 413

Section 413 empowers the court to make orders in connection with a s 411 scheme to merge two companies. This may involve the transfer of the whole or part of the undertaking and the property or liabilities of the transferor company. A parent corporation can effectively eliminate minority holdings in its subsidiary by a s 413 amalgamation whereby the minority holders are compensated under a related s 411 compromise or arrangement. The court, however, may make special provision "for any persons who, within such time and in such manner as the court directs, dissent from the compromise or arrangement".[134]

Issue 48: Does s 413 sufficiently protect dissenting minorities?

Selective share buy backs: Pt 2.4 Div 4B, Subdiv J

A selective buy back of public company shares, if permitted by the articles, must be approved by 75% in number and in nominal value of members who vote at a meeting of shareholders. The proposed vendors, and their associates, are precluded from voting. An expert report is required for a public company. The selective buy back is not a compulsory acquisition of a minority but merely a means for a company to acquire the shares that one or more members wish to sell. Court approval is not required. However, the procedure requires a declaration of solvency by the directors.[135]

The ASC submission to the Lavarch Committee pointed out that the exclusion from voting does not include a non-associated major shareholder, the proportion of whose shares may significantly increase as a result of a buy back.[136]

Issue 49: Who, if anyone, in addition to the vendor or its associates should be precluded from voting on a selective share buy back proposal?

Voluntary liquidation and selective distribution in specie: s 501

Minority interests can be eliminated through a voluntary winding up in which the majority shareholder receives the main undertaking of the company with a commensurate cash distribution to minority shareholders. A company's constituent documents must permit this form of distribution. The shareholders must also pass a special resolution to appoint a liquidator to wind up the affairs of the company and so distribute the property. The liquidator is obliged to act fairly in adjusting the rights of the contributories among themselves.[137] Minority shareholders may challenge this

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134 s 413(1)(e).

135 s 206MA(a).

136 ASC Submission to the Lavarch Committee at 120.

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

procedure by appealing from the decision of the liquidator[138] or seeking to remove the liquidator on the ground of unfitness to act.

Issue 50: Should there be specific disclosure requirements for voluntary liquidation resolutions where the company's constituent documents permit a selective distribution in specie?

Issue 51: Should persons who are eligible to receive selective distributions in specie, and their associates, be precluded from voting on the voluntary liquidation resolution?

Issue 52: Should individual shareholders have further rights to challenge selective distributions in specie?

Voluntary liquidation - amalgamation: s 507

The liquidator of a company, with a special resolution of shareholders, may arrange to transfer the whole or part of the company's business or property to another corporation, in return for the members of the company in liquidation receiving securities in the acquiring corporation.[139] In contrast to an amalgamation under s 413 involving a s 411 scheme, the approval of the court or the minority holders as a separate class is unnecessary. However, members who dissent from the special resolution may require the liquidator to buy their shares at a price determined by agreement or arbitration in the event that the liquidator wishes to implement the proposal.[140] A minority shareholder can therefore "opt-out" of the proposal, without the relevant amalgamation being defeated.

Issue 53: Should there be any specific disclosure requirements for any asset transfer resolution under a voluntary liquidation?

Issue 54: Should any member of the company who is the intended transferee of the company's business or property or an associate of the transferee be precluded from voting on the resolution?

Sale of assets and liquidation

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

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138 s 1321.

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

140 s 507(4).

Issue 55: Should the restrictions on sale of assets in the ASX Listing Rules be included in the Corporations Law? If so, should similar restrictions apply to unlisted public companies?

Other issues

Submissions are invited on the issues raised in this Paper and any other matters that are relevant to the proper regulation of compulsory acquisitions. The Legal Committee also welcomes proposals to simplify the drafting of the compulsory acquisition provisions.