

**GOVERNMENT RESPONSE TO
THE REPORT OF THE
PARLIAMENTARY JOINT
COMMITTEE ON
CORPORATIONS AND
SECURITIES ON THE
MANDATORY BID RULE**

On 7 December 1999, the Minister for Financial Services & Regulation, the Hon. Joe Hockey MP, requested that the Committee consider whether the framework for regulating takeover activity contained in the Corporations Law should be amended to include the Mandatory Bid Rule (MBR).

The MBR would allow a bidder to acquire shares above the statutory threshold of 20 per cent of the voting shares in a target company in advance of a formal takeover bid or announcement, provided the acquisition was immediately followed by an unconditional cash takeover bid for the remaining shares.

The MBR was included in the Government's Corporate Law Economic Reform Program Bill 1998. However the relevant provisions were removed from the Bill by the Senate on 13 October 1999. The MBR was therefore not included in the final version of the *Corporate Law Economic Reform Program Act 1999* (CLERP Act) that commenced on 13 March 2000.

The Parliamentary Joint Committee's Report on the Mandatory Bid Rule

The Committee tabled its report on the MBR on 21 June 2000. It recommended 'that the MBR as proposed in the CLERP Bill should be enacted'. It also recommended that the operation of the MBR should be reviewed two years after its commencement.

A dissenting report by the Committee's four Australian Labor Party (ALP) members recommended that the Corporations Law not be amended to include the MBR. It stated that 'the Labor Party does not believe that the advantages of such a rule outweigh its disadvantages'.

A minority report by Australian Democrats Senator Murray recommended 'that the MBR not be enacted at this time'. However it indicated that the Australian Democrats might be prepared to support the adoption of the MBR at a later date. Senator Murray's report indicated that the other reforms contained in the *Corporate Law Economic Reform Program Act 1999* (CLERP Act) as well as the introduction by the Government of rollover relief from capital gains tax in relation to scrip for scrip bids had the potential to increase the level of Australian takeover activity. It suggested that any decision concerning the introduction of the MBR should be delayed until the impact of these other reforms had been assessed.

The Government's Response to the Parliamentary Joint Committee Report

The Government supports the Committee's recommendation that the MBR proposed in the CLERP Bill should be enacted. In the Explanatory Memorandum accompanying the CLERP Bill the Government has already indicated that it would 'review the operation of the MBR two years after its commencement, to ensure that the Government's policy goals with the introduction of the mandatory bid are being achieved'.

In the light of the present views of the other parties in the Senate, the Government will not seek at this time to re-introduce legislation containing the MBR. Nonetheless, as the Government believes, for the reasons set out in the remainder of this response, that the implementation of the MBR would be a worthwhile reform, it remains committed to the introduction of the necessary legislative amendments at the appropriate time.

A More Efficient Market for Corporate Control

The Government believes that enactment of the MBR would enhance the efficiency of the market for corporate control in Australia. It would therefore complement other reforms to the regulatory framework governing takeovers in Australia contained in the CLERP Act.

Despite the positive contribution made by the CLERP Act reforms, the Government believes that the current regulatory framework continues to place unnecessary obstacles in the path of corporate takeover activity by preventing a bidder from obtaining a controlling stake in a target company except through a public auction process. This is because prospective bidders may refrain from launching takeover bids because of their reluctance to participate in a public auction process.

This reluctance is due primarily to the uncertainty inherent in launching a formal takeover bid and to the high transaction costs associated with takeovers. These costs derive from the potential for free riding and "greenmailing" by rival bidders as well as the scope available for the adoption of defensive tactics by target companies. The uncertainty and cost associated with takeover bids in the current environment reduces the contestability of the market for corporate control in Australia.

The enactment of the MBR will ameliorate these problems by providing potential bidders with the option of acquiring a controlling interest in a company without a public auction. This has the potential to reduce the uncertainty and costs associated with takeover bids which in turn can be expected to increase the contestability and efficiency of the market for corporate control in Australia.

A number of benefits can be expected to be derived from establishing a more efficient market for corporate control. Most importantly, the threat or increased prospect of a takeover can be expected to significantly enhance managerial performance and work to more closely align the interests of managers with those of their shareholders. This will significantly increase the pressure on corporate boards and managers to perform to the benefit of all shareholders in listed companies. Enhanced corporate performance would improve allocative efficiency by ensuring that corporate assets are put to their most valuable use. A more efficient market for corporate control can therefore be expected to benefit all shareholders whether a takeover occurs or not, as well as the economy more generally.

While the enactment of the MBR should reduce some of the uncertainties and costs associated with takeover activity, it will not necessarily reduce the size of the control premium paid by the bidder. This is because the MBR maintains and strengthens 'price tension' on the value of shares. Shareholders, including those with a substantial shareholding, have a powerful incentive to gain the highest possible price from any prospective buyer. This incentive is also evident in the case of so-called 'distressed sellers', since creditors will also seek to obtain the best price for a parcel of shares. Under the MBR shareholders would remain at liberty not to sell their shares or seek a better offer if they believe that the price being offered is too low and that a higher price could be obtained through a public auction process.

Protection for Minority Shareholders

The Government believes that the MBR provides ample protection for minority shareholders. A number of specific protections are afforded as part of the MBR provisions that would augment those provided by the other relevant provisions of the Corporations Law. As the Committee noted in its report, the requirement for the transfer of a controlling stake to be followed by an unconditional cash offer to remaining shareholders ensures that all shareholders have an opportunity to exit the company following the transfer of control. Conditional bids would be prohibited as these could deny minority shareholders the opportunity to exit the company.

The MBR would also maintain the principle of 'equal opportunity' by ensuring that minority shareholders participate in any control premium obtained by the initial seller. This is achieved by requiring the consideration offered to remaining shareholders as part of a mandatory bid to equal or exceed the value of the consideration received by the initial seller.

Under the Government's proposal, minority shareholders would remain at liberty to reject an offer to purchase their shares under a mandatory bid. Mandatory bidders would therefore face the potential prospect of being left without full control of the target at the completion of the bid period. As bidders would wish to avoid this predicament, they have a powerful incentive to offer sufficient consideration to ensure that remaining shareholders sell into the bid (including, if necessary, increasing the size of the consideration offered under the mandatory bid).

The MBR proposed by the Government also contains several further safeguards for minority shareholders. These include the right of minority shareholders to receive an independent report evaluating the adequacy of the consideration offered under the mandatory bid, prohibitions against the bidder exercising control of the target until after the beginning of the offer period under the mandatory bid, and restrictions against securities being issued, dividends declared or distributions made during the mandatory bid period. For these reasons, the Government does not accept the suggestion that small shareholders are more likely to be disadvantaged or presented with a *fait accompli* under the MBR.