Convergence or Divergence: Is there a Role for the Eggleston Principles in a Global M&A Environment?

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Australian transactions accounted for only a fraction of global mergers and acquisitions (M&A) capital flows in the 2001 calendar year, yet our takeover laws are widely regarded as some of the most restrictive among capitalist economies. In recent years, international practices have had a greater influence on the M&A market in this country. This paper considers the means by which this influence is manifested, paying particular attention to the role of practitioners and regulators. In the author's view, the continued 'convergence' of Australian takeover law and practice with that in the global arena is both inevitable and, if Australia is to remain desirable as a target for foreign investment, desirable. The paper concludes with a consideration of whether this 'convergence' can be pursued while maintaining the unique 'flavour' of the Eggleston Principles.

1. Introduction

The world was a very different place in the year 1969. While the *Eagle* lunar landing module touched down on the dark side of the moon, both the Boeing 747 and the Concorde made their maiden flights on Earth. The Woodstock Music and Art Festival in Bethel, New York State, attracted 400 000 people, while John Wayne won the Best Actor for 'True Grit' at the Academy Awards. Australia was still engaged in the Vietnam conflict. Computers with 10 per cent of the processing power as that on which the author typed this essay occupied entire rooms of scientific laboratories. A few were networked for the first time to create ARPANET, the predecessor to today's Internet.

Just as significantly, for present purposes anyway, in February 1969 the Commonwealth Parliament received the Second Interim Report of the Company Law Advisory Committee (the Eggleston Committee) to the Standing Committee of Attorneys-General, more commonly known as the Eggleston Report.[1]

Despite the radical transformation which has occurred in the way we live our lives, and more particularly the way business is conducted, since 1969, the report

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1 Company Law Advisory Committee, *Second Interim Report: Disclosure of substantial shareholdings and takeover bids* (Canberra: AGPS, 1969) (hereinafter Eggleston Report).

of the Eggleston Committee still provides the conceptual *grundnorm* for the operation of Australia's takeovers laws. We can take this as a sign that the Eggleston Report demonstrates either great resilience or hopeless obsolescence. As in most things, the answer probably lies somewhere in between.

What is certain is that the Eggleston Report provided a particularly Australian 'flavour' to our takeovers laws: one which, despite some similarities with the operation of the United Kingdom's City Code on Takeovers and Mergers,[2] is quite unique on a world scale.

The two questions which this essay poses are first, whether that uniqueness is likely to be maintained, and second, whether it is a good or a bad thing. The author's basic thesis is that the forces of globalisation in business are so powerful as to make a high degree of 'convergence' between our takeover law and practice and that of the major global capital markets practically inevitable, or at the very least, pragmatically essential. The author seeks to demonstrate how and why convergence is already occurring, with reference to three recent phenomena in the Australian M&A market — deal protection, proxy contests and the evolution of synthetic merger structures — focusing in particular on the important role which practitioners and regulators play in this process.

The article concludes with some tentative views on whether the philosophy of the Eggleston Committee will continue to have a role in a globalised M&A environment.

2. *The Eggleston Principles*

Both the scope of the reform mandate of the Eggleston Committee, and its resources, were relatively limited. The Committee was empowered to inquire into and report on the extent of the protection afforded to the investing public by the existing provisions of the Uniform Companies Acts and to recommend what additional provisions (if any) are reasonably necessary to increase that protection.[3]

Unlike the Corporate Law Economic Reform Programme (CLERP), the Eggleston Committee did not undertake a sweeping review of the policy basis for takeover regulation in this jurisdiction.[4] Most of its recommendations were in fact directed to 'closing loopholes in the present legislation, or improving the effectiveness of the controls already existing.'[5] However, in its most telling statement, the Eggleston Committee agreed with the 'general principle' that:

> [i]f a natural person or corporation wishes to acquire control of a company by making a general offer to acquire all the shares, or a proportion sufficient to enable him to exercise voting control, limitations should be placed on his freedom

2 Panel on Takeovers and Mergers, *City Code on Takeovers and Mergers* (London, 1968).

3 Company Law Advisory Committee, *First Interim Report: Accounts and Audit* (Canberra: AGPS, 1969) at para 1.

4 Explanatory Memorandum accompanying the Corporate Law Economic Reform Program Bill 1998 at paras 2.6, 2.10.

5 Id at 5–6.

of action so far as is necessary to ensure:

(i) that his identity is known to the shareholders and directors;
(ii) that the shareholders and directors have a reasonable time in which to consider the proposal;
(iii) that the offeror is required to give such information as is necessary to enable the shareholders to form a judgment on the merits of the proposal and, in particular, where the offeror offers shares or interests in a corporation, that the kind of information which would ordinarily be provided in a prospectus is furnished to the offeree shareholders; and
(iv) that so far as is practicable, each shareholder should have an equal opportunity to participate in the benefits offered.[6]

This 'general principle' provides the definitive statement of what has subsequently come to be known in Australia as the 'Eggleston Principles'.

Little has been written on the subsequent transmogrification of the Eggleston Principles into the written provisions of our takeover law, other than a very interesting article by Tony Greenwood.[7] Greenwood observes that the Eggleston Principles 'were the product of application of Sir Richard Eggleston's equity jurisprudence rather than of the economic analysis of law which has since become fashionable'.[8] He also notes that the conceptual gloss of an 'efficient, competitive and informed market'[9] was in fact the contribution of Mr Leigh Masel, at the time Chairman elect of the National Companies and Securities Commission (NCSC). In Greenwood's view, the introduction of this new principle, coupled with the unique innovation of an NCSC power to declare circumstances to be 'unacceptable',[10] 'signall[ed] change from the purely equity lawyers' approach'.[11]

The interaction between the Eggleston Principles on the one hand, and the concept of an efficient, competitive and informed market (which we should perhaps call the 'Masel Principle') on the other, is yet to be completely played out before either the courts or the Takeovers Panel. However, if Greenwood's analysis is accepted, the two are uneasy bedfellows: one is directed to an equitable objective of 'good takeover conduct', the other at economic objectives of efficiency in resource allocation. Clearly, those objectives may be diametrically opposed in some cases, as seemed to be implicit in the very mandate given to CLERP.[12] Yet there is evidence, for example in some Panel decisions, that a subtle form of 'fusion fallacy' may exist in this area, under which the Masel Principle is seen as little more than a convenient summary of the Eggleston Principles.[13]

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6 Id at 6.

7 See Tony Greenwood, 'In Addition to Justin Mannolini' (2000) 11 *AJCL* 308.

8 Id at 310.

9 Id at 311.

10 Ibid. Greenwood speculates that the phraseology of 'unacceptable circumstances' derives from Edward Heath's notion of the 'unacceptable face of capitalism'.

11 Ibid.

12 See also Bernard McCabe, 'The Information Effects of Takeovers' (1992) 2 *AJCL* 202.

13 See, for example, *Re Vincorp Wineries* (2001) 38 ACSR 584 at para 28 and *In the matter of Normandy Mining Limited (No. 2)* (Corporations and Securities Panel, 18 Feb 2002) at para 36.

What is clear is that the Eggleston Principles, and, just as importantly, the administrative mechanisms built around those principles (including the modification powers of the NCSC and its successor, the Australian Securities and Investments Commission (ASIC), and the powers of the Panel) represent a uniquely 'Australian' attempt to address innovations in takeover practice at the 'unacceptable' end of the creative spectrum. This author has noted elsewhere that it is difficult to rationalise the Eggleston Principles in terms of economic efficiency.[14] Rather, in the author's view, they epitomise the Australian cultural imperative of a 'fair go for all', or perhaps even more accurately, a preference for the 'battler' over the 'big end of town'. Despite the fact that the structural characteristics of our capital markets are such that larger players (brokers, institutions and major private investors) will always enjoy a competitive advantage over 'mums and dads',[15] the Eggleston Principles at least provide the latter group with a level of 'buy in' to major corporate transactions which, in all likelihood, they simply would not have in an unregulated market for control. This 'buy-in' is viewed by those responsible for the writing of our takeover laws as politically expedient, particularly in light of the democratisation of share ownership in this country in the latter part of the last century.

To this extent, the continued survival of the Eggleston Principles is arguably a manifestation of Mark Roe's 'political paradigm', under which the evolution of market structure is regarded as path dependent: in Roe's view the origin of the fundamental precepts of corporate finance law 'lies in technology, economics *and* politics'.[16] In other words, our pervasive cultural characteristics (and indeed those of other idiosyncratic jurisdictions such as Japan and Germany) act as a buffer against globalisation.[17]

However, despite the existence of this buffer, globalisation is now affecting every aspect of our lives — from the food we eat and the clothes we wear to the kinds of financial products available to us — providing both opportunities and challenges to a relatively small politico-economic entity such as Australia. The market for corporate control is no exception. Recent debate over the 'branch office economy syndrome' serves as ample evidence of this.[18] If Australia is to compete effectively on a world scale in order to attract capital, can it afford to maintain the 'luxury' of economically inefficient (albeit admirably egalitarian) rules such as the

14 Justin Mannolini, 'CLERP and Takeover Law Reform – Politics Trumping Principle' (1999) 10 *AJCL* 193.

15 Those characteristics include, amongst other things: superior access to information (although this advantage is being diminished thanks to the Internet), greater buying power, superior training and technical knowledge and access to a network of 'contacts' and advisers. For a judicial consideration of those advantages see *Aberfoyle Limited v Western Metals Limited* (1998) 28 ACSR 187 at 222–223.

16 Mark Roe, *The Political Roots of American Corporate Finance* (1994) at 21.

17 For an interesting perspective on the importance of cultural characteristics in the context of convergence in corporate law, see Douglas M Branson, 'The Very Uncertain Prospect of "Global" Convergence in Corporate Governance' (2001) 34 *Cornell International LJ* 321 at 341–343.

Eggleston Principles? Or must we, as some law and economics scholars theorise, inevitably converge towards the Anglo-American efficiency-based hegemony?[19]

In the author's view, some clues to this puzzle exist in recent trends in our own jurisdiction. Globalisation is already having a profound effect on the Australian M&A market, through a process of gradual importation, and assimilation, of practices in other developed markets. Some of those practices are either antithetical to, or at least present challenges to, the Eggleston Principles in their pure form. Given the apparent lack of political will, it is largely being left to the creativity of practicing lawyers, and the flexibility of regulators, to deal with the tension between our local takeover laws and those in the markets which serve as our main suppliers of capital. The next section of this essay considers some examples of how this tension has arisen and, in some cases, been resolved.

3. How a Globalised M&A Environment Affects Australia

A. Introduction

Practitioners and regulators in the corporate and financial sector have an extremely important role to play in the process of convergence between our takeover laws and those of other jurisdictions. Practitioners are, to borrow the words of Stanford Law School academic Ronald Gilson, 'transaction cost engineers', busily acting as organisational intermediaries, designing transaction-cost efficient structures through which their principals engage in economic activities.[20] We have witnessed this process through developments in the way takeovers are conducted and the substance and form of documentation which we as lawyers prepare to give effect to control transactions. That process would not be surprising to a lawyer in the United Kingdom or the United States.

But what is unique about Australia is that not only practitioners, but also regulators (most importantly ASIC and the Takeovers Panel, but also the Australian Competition and Consumer Commission (ACCC) and Foreign Investment Review Board (FIRB)), are empowered and willing to play a very similar role, albeit with a mandate to secure not necessarily the commercial objectives of the parties, but the attainment of the applicable regulatory policy objectives.[21] Not surprisingly, the vigour with which the latter are pursued, sometimes at the expense of the former, tends to vary in line with a number of

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18 This refers to the process by which meaningful control of Australian companies is, through foreign mergers and acquisitions, transferred to offshore interests, leaving domestic corporate headquarters to function as 'branch offices'. See Tim Bednall, 'How To Beat The Branch Office Syndrome' *Australian Financial Review* (7 Jan 2002) at 47; Damon Kitney & Ian Howarth, 'Reform Or Be A Branch Office: BCA' *Australian Financial Review* (19 Mar 2001) at 13; Peter Robinson, 'Don't Knock The Branch Office' *Australian Financial Review* (5 Apr 2001) at 66; Tim Treadgold, 'The Mailbox Economy' *Business Review Weekly* (1 Jun 2001) at 50.

19 For a more detailed consideration of this question, see John C Coffee, 'The Future as History: Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwestern U LR* 641 and Branson, above n17.

20 Ronald J Gilson, 'Value Creation by Business Lawyers: Legal Skills and Asset Pricing' (1984) 94 *Yale LJ* 239.

factors, including the prevailing political sentiment. However, in the author's view, subject to a few anomalies,[22] what we have seen from the regulators in recent years is a *gradual* but growing recognition of their facultative role in M&A transactions, particularly those with a cross-border element. In short, regulators appear to be waking up to the realities of life in a globalised M&A environment.

A couple of related points should be noted at this juncture. The first is that the Australian M&A intermediary market itself has not been immune to the effects of globalisation. In the 1970s and 1980s, the Australian corporate advisory market was dominated by the corporate finance offshoots of the principal stockbroking firms and a few niche players. The real driving forces of the global M&A market, the American merchant banks, were practically nowhere to be seen. It was only with the deregulation of the financial system in the 1980s that the American banks made their first tentative forays (with mixed success) into the domestic market. In the 1990s, the pace of acquisition of local firms by international banks steadily increased, and other global players established significant permanent presences in the local market, to the point where offshore institutions now dominate the Australian M&A landscape.[23] In the legal services market, the large global firms have also been extending their reach, although thus far pausing in north Asia (perhaps to catch their breath before a full-scale onslaught). Although there has not, in Australia, been the same acquisition frenzy that has gripped the corporate advisory market, increasingly overseas (particularly United Kingdom) firms are taking the lead advisory role in cross-border mergers and acquisitions, with the domestic firm relegated to a secondary or 'signoff' role.[24] Recent developments in the domestic legal services market suggest that while wholesale law firm mergers are unlikely in the short term, international networks, joint ventures and 'best friends' arrangements will become more prevalent.[25]

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21 ASIC has extensive powers to modify the application of the takeovers provisions of the *Corporations Act* 2001 (Cth): see *Corporations Act* s655A. The Takeovers Panel may review any decision of ASIC to modify the law in this manner: see *Corporations Act* s656A. The Takeovers Panel has shown a willingness to make orders effectively modifying the Corporations Act in circumstances where ASIC was not willing to do so: see the decision in *In the Matter of Bigshop.com.au (No. 3)* (Corporations and Securities Panel, 22 October 2001). The ACCC exerts its influence over M&A activity through a combination of the authorisation process and conditions it attaches to 'informal clearance' (for example, through the enforceable undertaking mechanism): see *Trade Practices Act* 1975 (Cth) ss50, 87B and 88 and Australian Consumer & Competition Commission, *Merger Guidelines* (Canberra: AGPS, 1999). The FIRB makes recommendations to the Commonwealth Treasurer as to foreign acquisitions and takeovers under the *Foreign Acquisitions and Takeovers Act* 1975 (Cth).

22 The ACCC in particular has been subject to criticism on this front. See Peter Cullen, 'High Hopes For Business Review' *Australian Financial Review* (14 Jan 2002) at 24; 'Taking Corporate Watchdog To Task' *Australian Financial Review* (11 Jan 2002) at 40, 56.

23 In the 12 months to 31 October 2001, the top M&A adviser in Australia was UBS Warburg, which advised on deals worth US$25.9 billion. Global merchant banks occupied 10 of the top 15 rankings (source: DEALOGIC, as reported in *Business Review Weekly* (29 Nov 2001) at 24.

24 This is not surprising given the dominance of the Anglo-American paradigm of shareholder proprietorship which lies at the heart of most acquisition activity, particularly hostile acquisition activity. See Scott Mitnick 'Cross-Border Mergers and Acquisitions in Europe: Reforming Barriers to Takeovers' (2001) 3 *Columbia Business LR* 683 at 699–707.

These phenomena are not just of interest from bankers' and lawyers' business perspectives. They are contributing to the direct and rapid importation of M&A law and practice from some of the most advanced and active capital markets in the world. The process has been accelerated by concurrent advances in communication and information technology (most obviously universal information search and retrieval solutions based around the Internet architecture), which in large measure make the latest in global law and practice available (at very low marginal cost) at the desktop. The markets are becoming globalised but, as importantly, knowledge itself is becoming globalised.

The second, inescapable fact to note is that Australia has an extremely small capital base by world standards, notwithstanding its pre-eminent role in a number of market segments, particularly mining and commodities. This in turn is due to a fairly low historical rate of gross domestic savings, notwithstanding Government initiatives such as compulsory superannuation levies designed to remedy this situation. In short, we are, and are likely to remain for some time, a capital importing economy. And there does appear to be a growing recognition that, like any economy pitching for its fair share of the global capital pool, we must present an appropriate legal face to the market,[26] a proposition which applies *a fortiori* to capital importing economies.[27] A stable political system, independent judiciary, reliable money supply and recognition and protection of property rights are all critical.[28] So too, however, is regulatory responsiveness.[29] In a practical sense, foreign investors are likely to favour jurisdictions with regulatory systems broadly consistent with their own (other things being equal). They are most likely to seek to apply techniques which have been successful and appropriate either in their own or other advanced capital markets in which they operate. If the local regulatory regime does not permit what would otherwise be allowed in the foreigner's home jurisdiction, two things inevitably result: first, considerable frustration, and second, pressure on advisers to 'find a way around' the problem. In some cases, the practitioner will have no option but to seek the assistance of the regulator. Their combined task is then to find ways (provided they are consistent with regulatory policy) to achieve (often by synthetic means) what is not otherwise permitted under the domestic regulatory regime. By this process of gradual evolution, more and more of what legal and financial advisers and regulators do tends to represent adaptation of international practice to domestic conditions.[30]

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25 See, for example, the 'best friends' agreement between Slaughter & May and Allens Arthur Robinson relating to the provision of legal services in the Asia-Pacific region: <http://www.aar.com.au/publications/pdf/sm.pdf> (24 July 2002).

26 This is analogous to the process of state 'jurisdiction competition' which took place in the United States during the latter 20th century, leading eventually to the dominance of the Delaware governance model: see William L Cary 'Federalism and Corporate Law: Reflections Upon Delaware' (1974) 83 *Yale LJ* 663.

27 See Amir N Licht 'David's Dilemma: A case Study of Securities Regulation in a Small Open Market' [2001] *Theoretical Inquiries in Law* 673.

28 Coffee, above n19 at 648.

29 See Stephen J Choi, 'Assessing Regulatory Responses to Securities Market Globalisation' [2001] *Theoretical Inquiries in Law* 613.

The third point to note is that, quite possibly as a result of the structural characteristics of the Australian regulatory regime, which tend to devolve considerable decision making authority to the administrative level, key regulators themselves are not immune to the forces of globalisation.[31] Here, globalisation is most directly manifested through the activities of the business lobby. Of course, given the lack of transparency which inevitably affects this process, it is difficult to speculate as to the objective level of influence of the business lobby over the development of legislative reform and regulatory policy in any one area. Our own Takeovers Panel, however, provides an interesting case in point. The business lobby lay behind reforms to shift the power to declare circumstances unacceptable away from the NCSC and towards an independent panel (the conflict of interest inherent in the previous system was plain for all to see). An expansion of the Panel's role and powers was the subject of considerable and sustained support from the business lobby, including bodies such as the Securities Institute of Australia.[32] No doubt that support was motivated by a belief that a panel comprised substantially of M&A intermediaries was more likely to prefer facultative outcomes in M&A disputes than the Courts, which were viewed as hidebound by legal formalism.[33] When the legislature finally delivered, the Panel was given an express and very broad mandate to pursue an 'efficient, competitive and informed' market for corporate control:[34] Parliament intended that although the Eggleston Principles 'remain relevant in this regard', the Panel should be able 'to deal with any conduct which amounts to a contravention of the spirit of the legislation where appropriate'.[35] Although the precise meaning of this phrase (suggestive as it is that application of the Eggleston and Masel Principles may yield contrary outcomes in some cases) is yet to be fully articulated by the courts or the Panel, it is clear that the Panel now regards it as at least *part* of its role to ensure that the market for corporate control in Australia is competitive when assessed against other world markets. To this extent, in the author's view, the recent *structural* reforms to the M&A regulatory regime are likely to overcome some of the political barriers to substantive reform, diminishing the degree of path dependency which has otherwise afflicted our takeover laws.

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30 For example, in releasing its draft Guidance Note on Lock-up Devices, the Panel expressly acknowledges that it had taken into account a range of factors 'including overseas experience and rules on break fees and other lock up devices', in developing a draft policy which 'suits the Australian market and jurisdiction': see Takeovers Panel, *Panel releases policy on lock up devices for comment* (2 August 2001).

31 See Jonathan R Macey, 'Administrative Agency, Obsolescence and Interest Group Formation: A case Study of the SEC at Sixty' (1994) 15 *Cardozo LR* 909.

32 See John M Green, 'An Australian Takeover Panel – What do we want? A Panel Poll and Critique' (1989) 7 *C&SLJ* 6.

33 See G F K (Kim) Santow & George Williams, 'Taking the Legalism Out of Takeovers' (1997) 71 *ALJ* 749. The evidence to date bears this out, with the vast majority of Panel applications resolved by negotiation and voluntary undertakings.

34 *Corporations Act* s602(a).

35 See Treasury, *Corporate Law Economic Reform Program (CLERP) Proposals for Reform Paper No 4: Takeovers* (Canberra: AGPS, 1997) at 38.

The recent controversy over the ACCC's approach to section 50 of the *Trade Practices Act* provides an interesting counterpoint. While not all share its views, the business lobby argues that the 'substantial lessening of competition' formulation in that section is impeding the development of 'national champions' which are able to compete effectively at a global level.[36] Perhaps in this area, regulatory discretion is restricted to such an extent that legislative reform will be required to facilitate further convergence with international norms, in which case we may expect the evolution of competition law to demonstrate a greater level of path dependency than takeover law.

Although there are obvious anomalies,[37] the three factors described above have tended to coalesce towards a more fluid regime for the acquisition of corporate control in Australia: in short, capital mobility is being preferred over minority protection — efficiency over equality — Masel over Eggleston.[38] The following sections of this essay consider this trend by reference to three phenomena in the domestic M&A market, namely deal protection, synthetic structures and proxy contests.

B. Deal Protection

Deal protection, particularly through the use of break fees, has attracted significant attention in Australia in recent years, some would say out of all proportion to the importance of the issue in terms of domestic M&A practice.[39]

From an Australian practitioner's perspective, break fees are really only important at the margin of significant M&A transactions, since for various reasons, discussed below, such fees are generally not large enough to significantly affect competitions for control. Where fees may prove more significant in the future is in relation to smaller transactions, particularly in the so-called 'public to private' market,[40] where both the universe of potential acquirers and the average premia paid may not be as great.

Although there were earlier precedents,[41] break fees seemed to be 'reactivated' as a controversy in 2000, when AngloAmerican plc sought and obtained a break fee undertaking from North Limited, which was at the time defending an

36 'Business Push For New Laws on Mergers' *Australian Financial Review* (3 Dec 2001); Aaron Patrick, 'Chance To Rein In ACCC's Power' *Australian Financial Review* (17 Oct 2001) at 6.

37 On the FIRB front, anomalies include the rejection of the Royal Dutch/Shell Group's takeover bid for Woodside Petroleum Limited in 2001. ACCC intervention has been more common: see, for example, in relation to the Cable & Wireless Optus Limited bid for AAPT Limited, ACCC, *Cable and Wireless Decision Not to Proceed Welcomed* (31 May 1999).

38 For an interesting treatment of these issues from conflicting viewpoints, see Jeffrey Lawrence, 'The Economics of Market Confidence: (Ac)Costing Securities' (2000) 18 *C&SLJ* 171 and G Hughes, 'Compulsory Acquisition of Minority Shareholders' Interests — Still a Tyranny of the Majority?' (2000) 17 *C&SLJ* 197.

39 See Justin Mannolini & Andrew Rich, 'Break Fee Agreements in Takeovers' (2001) 19 *C&SLJ* 222; Takeovers Panel, *Lock-up Devices Guidance Note* (7 Dec 2001).

40 The reference to 'public to private' here is to transactions funded by financial buyers, such as private equity funds, rather than trade buyers.

41 Above n39 at Appendix.

unwelcome but ultimately successful advance from the Rio Tinto group. The fee in that case was just over 1 per cent of the notional deal value of $3.1 billion. It is interesting to note that the corporate advisers in that case were each significant global M&A players: Credit Suisse First Boston (for Anglo American) and Merrill Lynch (for North Limited). Both would have been familiar, as a result of their experience in European and North American jurisdictions, with the use of break fees covering advisers' fees, internal expenses (salaries, travel etc), financing costs (including commitment fees on bank finance) and even opportunity costs. The North Limited break fee, and subsequent similar fees, have attracted significant attention in the financial press,[42] despite the fact that, ultimately, they were modest in comparison to United States precedent and appear to have had little bearing on the outcome of transactions.

The controversial nature of break fees here stems at least in part from the lack of a coherent approach in Anglo-Australian law to the duties of target company directors. The handful of superior court decisions on such duties have provided an awkward framework within which to assess the validity and enforceability of break fee agreements, 'lock-ups', 'no-shops' and other so-called deal protection mechanisms. This is largely the result of the Courts' adherence to the separate legal entity doctrine. While offering some scope for pragmatism on a case-by-case basis, the separate legal entity concept is not particularly helpful in arbitrating between the competing claims of different groups of shareholders, as come into play when break fees are involved.[43] Here the interests of one body of shareholders — those who receive a takeover offer — are at odds with another: the successful competing bidder who indirectly funds the fee. The debate is whether the directors discharge their duty to 'the company' by agreeing to pay out its funds to entice an offer for the exiting shareholders' shares.

Our own Panel has recently entered into the fray, proffering a 1 per cent cap on break fees as an appropriate guideline for target company boards, except perhaps in large transactions.[44] It should be noted, of course, that the Panel's concern is not whether the payment of the fee is consistent with the target company directors' fiduciary obligations. Rather, its mandate is to determine whether the fee interferes with the operation of an 'efficient, competitive and informed market' for corporate control, which is arguably a more transparent test in the context of a specific transaction. The release of the Panel's policy appears to have had an immediate effect on the practice on the Australian market. Break fees of up to 1 per cent are now a relatively common feature of the M&A landscape and another addition to the lawyers' checklist of common items for negotiation in advance of an agreed transaction. But it is still an open issue whether such fees offend fiduciary principles.

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42 See Maureen Murrill, 'Billiton and BHP set a $200 million jilting fee' *Business Review Weekly* (30 Mar 2001).

43 See *Percival v Wright* [1902] 2 Ch 421; Cf *Brunninghansen v Glavanics* (1999) 46 NSWLR 538. See also Michael Whincop, 'Overcoming Corporate Law: Instrumentalism, Pragmatism and the Separate Legal Entity Concept' (1997) 15 *C&SLJ* 411.

44 Takeovers Panel, above n39 at paras 14–16.

The London Panel takes a similar approach to our own, but builds in a number of procedural safeguards. For example, the City Code requires the target company board and financial advisers to confirm to the London Panel in writing that they believe the fee to be in the best interest of shareholders. The London Panel is also required to be consulted 'at the earliest opportunity' in all cases where an inducement fee or similar arrangement is proposed. Like our Takeovers Panel, the London Panel requires that any fee be 'de minimis', which is generally assumed to be 1 per cent or less than the transaction value.[45]

Although our Takeover Panel's approach is broadly in line with the position under the City Code, it represents a more conservative position than prevails in the United States, where break fees commonly run between 2 per cent and 4 per cent of transaction value.[46] One of the most important differences between the United States and Australia, of course, is that in the latter there is no direct equivalent of the Eggleston Principles or the concept of 'unacceptable circumstances'. Accordingly, it is relatively common for target company boards to use break fees and other similar 'lock up' devices to 'ensure the bidder a return on the investment it makes in evaluating and implementing the deal and to warn off hostile interference'.[47] Generally speaking, such devices are not considered by the United States courts to be invalid per se, but not surprisingly, they are subject to enhanced judicial scrutiny and occasional invalidation.[48]

Debate in the United States thus rages over recognition of a conceptual divide between 'foreclosing' lock ups, which prevent a high evaluating party from acquiring control, and 'facilitating' lock ups, which have a positive effect.[49] By and large, United States courts have grappled with that issue in the broader context of directors' duties to facilitate an auction for the target company shares.[50] In Australia, on the other hand, the impact of the Eggleston and Masel Principles, combined with the Takeovers Panel's own view on the subject, combine to render that debate substantially redundant: it seems inevitable that a break fee which did have the effect of foreclosing an auction for control of an Australian company

45 Panel on Takeovers and Mergers, *City Code on Takeovers and Mergers* (London, 1968), Rule 21.2.

46 For example, in the recently announced Compaq/Hewlett Packard merger, the break fee was struck at US$670m, or 2.7 per cent of the notional deal value.

47 Michael Klausner & Marcel Kahan, 'Lockups and the Market for Corporate Control' (1996) 48 *Stan LR* 1539 at 1540.

48 See *Unocal v Mesa Petroleum Corp.*, 493 A.2d 946 (1985); *Paramount Communications v QVC Network Inc.*, 637 A.2d 34, 39 (1994).

49 Ian Ayres, 'Analysing Stock Lock ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?' (1990) 90 *Columbia LR* 682 at 704. See also Stephen Fraidin & Jon D Hanson, 'Unlocking Lock ups' (1994) 103 *Yale LJ* 1739 at 1834. It is interesting to note that in the City Code, these fees are referred to not as break fees but as 'inducement fees'.

50 See *Revlon, Inc. v McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (1986); Mannolini & Rich, above n39 at 234–235. Subsequent cases have considerably eroded what has come to be known as the 'Revlon duties' of target company directors.

would be struck down by the Panel.[51] To refer to such fees as a form of 'deal protection' at all is therefore probably misleading.

Perhaps a more interesting avenue for considering the impact of globalisation on deal protection techniques is the increasingly sophisticated use of pre-bid agreements as a prelude to takeover activity. The objective in these cases is 'deal protection' in the pure sense: establishing lawful and effective barriers to the auction process, or favouring one bidder over another. The first steps towards this goal came through the use of what are now commonly referred to as 'pre-acceptance agreements'. Like break fees, although originally novel and controversial, pre-acceptance agreements have now become an accepted weapon for potential bidders. In effect, they permit the selling shareholder to have the benefit of any increase in the offer price, while giving the bidder a 'toehold' in the target. However, as pre-acceptance agreements confer a relevant interest in the underlying securities,[52] they can still only be used up to maximum of an initial holding of 20 per cent, unlike in the United Kingdom where 'irrevocable commitments' to accept an offer can be sought in advance of the bid.

We have therefore seen some interesting examples of attempts to achieve, by synthetic or economic means, a degree of commercial certainty that a controlling block will be delivered into a takeover bid. A particularly interesting example is provided by Singapore Telecommunications Limited's bid for Cable & Wireless Optus Limited in 2001. In that case, the target's major shareholder, Cable & Wireless plc, agreed to (amongst other things) sell to the bidder 19.9 per cent of the target company shares and to pay a fee if it disposed of its remaining parcel of shares into a competing bid.[53] The quantum of the fee was calculated to provide a clear economic disincentive to Cable & Wireless to dispose to a competing bidder. However, there was no legal prohibition upon its doing so, the parties apparently taking the view that this was sufficient to avoid giving rise to a 'relevant interest' in the underlying shares, even under the broad definition of that term in the *Corporations Act*.[54]

Other deal protection opportunities have been provided by reforms to the law relating to collateral benefits. Under CLERP, the former section 698 of the *Corporations Law* was substantially amended, including by eliminating the four month 'relation back period'.[55] Collateral benefits are now only prohibited during the offer period.[56] However, any collateral benefits provided prior to the opening of the offer must be disclosed[57] and, in addition, such benefits must not be so

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51 This seems to be implicit in the Panel's decision in *In the matter of Normandy Mining Limited (No 3)* (Corporations and Securities Panel, 28 January 2002) at paras 29–34.

52 *Corporations Act* s608(8).

53 Clause 1 of the Agreement dated 25 March 2001, a copy of which is attached to Singapore Telecoms' Form 603 dated 27 March 2001.

54 See in particular *Corporations Act* s608(1). An argument could be made that the agreements gave Singapore Telecommunications sufficient 'economic control' over the Cable & Wireless stake to give rise to a relevant interest: see in particular the rules of interpretation in *Corporations Act* s608(2). However, no objection to the structure was ever raised.

55 *Corporations Law* s698(4).

56 *Corporation Act* s623.

profound as to give rise to 'unacceptable circumstances' in any particular case. Despite these limitations, it may be possible for an offeror to stream benefits to a particular offeree in a manner which does not offend either the letter or spirit of the law. One possible example is provided by the structure of the Newmont Limited offer for Normandy Mining Limited, which involved a simultaneous offer for the shares in Franco Nevada Mining Corporations Limited, a substantial shareholder in Normandy.[58] We have seen other examples in which bidders have induced controlling shareholders to part with their stakes on the promise of collateral benefits structured in such a way as to avoid the prescriptive provisions of the Corporations Act. For example, in the case of the Stockland Group's bid for Advanced Property Fund, the benefits comprised a range of cross marketing opportunities and the assumption of responsibility for certain employees who would otherwise be rendered redundant as a result of the acquisition: these benefits were considered by the Takeovers Panel not to offend the Eggleston Principles.[59] In the case of the bid by the Ramsay Healthcare Group for Alpha Healthcare Limited, the benefit was in the form of a parallel acquisition of debt in the marginally solvent target from an offeree shareholder, which the Panel also held to be acceptable.[60]

In each of these cases, the objective of the acquirer and its advisers has been to interfere with the free workings of the market for corporate control. It seems inevitable that, in one case, in doing so the protagonists will go so far as to offend the Masel Principle. But to date the Panel has adopted a fairly 'pro-bidder' stance towards these techniques, particularly where (as was the case in the Normandy Mining and Advance Property Fund cases), they facilitate the introduction of a new bidder into the auction process.

C. Proxy Contests

Traditionally in Australia, competitions for control of company boards have taken place in a 'back room' environment. Only rarely did boardroom skirmishes spill into the public arena. However, in recent years we have noticed a definite trend towards increased use of the meetings mechanisms under the *Corporations Act* to achieve changes in corporate control, both as an adjunct to traditional M&A techniques and on a stand alone basis.[61] The boards of Anaconda Nickel Limited, Asia Pacific Speciality Chemicals Limited, Western Metals Limited and Ausdoc Group Limited have all recently found themselves on the end of spill resolutions initiated by major shareholders.

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57 *Corporations Act* s636(1)(i).

58 See *In the Matter of Normandy Mining Limited (No.4)* (Corporations and Securities Panel, 11 January 2002).

59 See *In the Matter of Advance Property Fund* (Corporations and Securities Panel, 9 October 2000).

60 See *Re Alpha Healthcare Ltd* (2001) 39 ACSR 238.

61 See Damon Kitney & Stewart Oldfield, 'Directors Under Pressure' *Australian Financial Review* (19 Nov 2001) at 1,18.

In the author's view, there is anecdotal evidence of three catalysts for the growth in this technique.

The first probably correlates somewhat with the importance of shareholder political rights in the United States, where proxy fights are a relatively common feature of the M&A landscape. This is particularly so where the target company constitution contains 'poison pill' provisions which are capable of being removed or 'redeemed' by the incumbent board. In Australia, such provisions are generally prohibited under the *ASX Listing Rules*, but target company directors still have a range of powers and discretions which can impact upon the success of a takeover, including control over the substance and timing of corporate disclosure and board recommendations (on which particular emphasis is placed by retail shareholders). In the author's view, the growth in the use of proxy contests, particularly when conducted contemporaneously with a conventional takeover, may be evidence that our laws are not efficiently aligning the interests of target company shareholders and management in contested takeovers. We may be affording too much discretion to incumbent management.

A second factor explaining the growing popularity of proxy contests may be the existence of our 20 per cent takeover threshold and the absence of a mandatory bid rule (or equivalent). Many foreign bidders contemplating an acquisition in Australia are deterred by the relatively substantial costs they may incur in becoming involved in the public auction process which the takeover provisions of the *Corporations Act* mandate. These include the considerable cost of target search, identification and valuation, out of pocket expenses such as advisers' fees and travel, and internal costs such as management time. Because in our jurisdiction a bidder cannot acquire an initial stake of more than 20 per cent, most of these costs will need to be incurred before the bidder has any certainty of deal completion. In addition, because the bidder will, to ensure success, be required to 'bribe' the more optimistic target company shareholders to sell, the cost of the acquisition will be further increased.[62]

In these cases, the lawyer may, as noted above, be called upon to supply the most effective deal protection mechanism available. This will be particularly difficult in the case of a fragmented target shareholding. If there is no viable deal protection strategy, the focus of attention may shift to means by which the target board can be 'squeezed' without the bidder incurring the significant cost of a general offer. This is particularly so in the case of under-performing targets: in such cases, the client's (quite valid) question is frequently: 'why should I have to bail out the minorities when I am not even sure of the value proposition myself?'

In reality, what we are seeing in this reticence is an expression of the 'free rider' problem which is endemic in our takeover market. Because of the way our takeover laws operate, a bidder is unable to garner all the benefits of the announcement of its bid. Some, and in most cases a large proportion, of the benefits of that initiative, are shared by minority shareholders and by other

62 See Justin Mannolini, 'The Reform of Takeover Law — Beyond Simplification' (1996) 14 *C&SLJ* 471.

bidders.[63] This in turn is likely to produce a sub-optimal level of monitoring and bidding activity by (actual or potential) shareholders.

In proxy contests, on the other hand, costs and benefits of monitoring tend to be shared closer to pro rata with shareholdings. This is a better outcome for the initiator of the contest, even if the correspondence between costs and benefits is imperfect.[64]

A third factor explaining the growing use of proxy contests may be shortcomings in our continuous disclosure laws. Proxy contests can prompt the target board to release additional information on which a prospective bidder can base a decision whether or not to make a general offer. This is likely to be a particularly important factor in two cases: first, where the target's disclosure is incomplete or sub-optimal, and second, where the information valued by the bidder is 'soft' information (such as intentions, business plans or proposed divestments or acquisitions) which may otherwise be beyond the scope of our continuous disclosure laws.[65] A possible example of the latter is the recent dispute between the board of Ausdoc Group Limited and a substantial shareholder, Babcock & Brown, which was settled only with the appointment of two nominees of the prominent institutional investor to the Board of Ausdoc.[66] There is some evidence that recently enacted fair disclosure regulations in the United States are also contributing to a sub-optimal level of disclosure of 'soft information'.[67]

In summary, it may be possible to view the growth in proxy contests as tentative evidence of systemic failure of three critical elements of Australian takeovers law: the rules relating to defensive conduct, the structure of the takeover threshold and the absence of a mandatory bid rule, and the rules relating to continuous disclosure, all of which may be contributing to a net aggregate deficiency in the level of shareholder monitoring of board performance.[68]

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63 P Crampton & A Schwartz, 'Using Auction Theory to Inform Takeover Regulation' (1991) 7 *Journal of Law, Economics & Organisation* 27. See also above n12.

64 There is provision in the shareholder-convened meeting sections of the *Corporations Act* for limited sharing of costs: see, for example, *Corporations Act* s249P, which obliges the company to bear the cost of distributing a statement of not more than 1000 words in connection with any resolution or other matter able to be properly considered at a general meeting. However in more significant proxy contests, the initiator is likely to expend additional funds in the solicitation process, including the costs of sending printed materials to shareholders.

65 See in particular *ASX Listing Rule* 3.1 and the exceptions thereto.

66 See Peter Kormeandy, 'Surprise Compromise at Ausdoc' *Australian Financial Review* (1 Feb 2002) at 64.

67 See John Labatte, 'SEC takes action on disclosure violations' *Financial Times* (7 Apr 2002).

68 See Geof Stapledon, 'Disincentives to Activism by Institutional Investors in Listed Australian Companies' (1996) 18 *Syd LR* 152.

The regulatory response to these issue has been muted, although thanks to recent high-profile collapses, there is a growing chorus of complaint over our continuous disclosure laws and the prospect of some legislative reform.[69] Both ASIC[70] and the ASX[71] have responded with guidance on appropriate disclosure, but it must be said that the quality of corporate disclosure in Australia remains poor, particularly in the area of 'soft' information.

There has recently been some recognition by ASIC that the structure of our takeovers law, and in particular the breadth of the concept of 'relevant interests' in shares, makes collective action by shareholders difficult (and in some circumstances legally impossible), which may have 'the unintended consequence of preventing institutions from actively participating in corporate governance issues'.[72] ASIC has provided limited class order relief to institutional investors which can facilitate collective voting.[73] The relief is available only to a fairly narrow range of professional portfolio investors. The relief is not available to non-portfolio investors and it is not yet clear whether ASIC would be prepared to entertain relief on a case by case basis for such investors.[74]

However, one interesting thing to note (taking for a moment a public choice perspective) is that non-portfolio investors as a class appear to be under represented at a political level relative to institutional shareholders, as evidenced, perhaps, by ASIC proposals for the liberalisation of takeovers and substantial holding provision in favour of investments funds.[75] If this is correct, it seems likely that in the short term, innovations are likely to take place on a case by case basis. Practitioners will again play a critical role in the development of new techniques.

Another point to note is that this will be one area which will still largely be the domain of the courts, rather than the Panel, since in most cases the proponent will not acquire a 'substantial interest' in the target.[76] Accordingly, a 'pure' proxy fight would be beyond the purview of the Panel, unless it was accompanied by the acquisition of a 'substantial interest' in the target company.[77] The courts themselves have had relatively few opportunities to consider the operation of the meeting machinery provisions of the *Corporations Act* and related common law

69 See Alan Kohler, 'Disclosure Road to Nowhere for ASIC as Rules Lack Sting' *Australian Financial Review Weekend* (8–9 Dec 2001) at 15,72; Bill Pheasant, 'Campbell continues to push Company Law Reform' *Australian Financial Review* (10 Dec 2001) at 7.

70 ASIC, *Guidance Principles Better Disclosure for Investors* (23 August 2000).

71 ASX, *Guidance Note 8 Continuous Disclosure: Listing Rule 3.1* (September 2001).

72 See ASIC, *Collective Action by Institutional Investors Policy Statement 128* (8 July 1998) at para 3.

73 *ASIC Class Order* 00/455.

74 The tenor of the relevant policy statement, above n72, suggests otherwise: see particularly at para 16.

75 See ASIC, *Investment Funds: Takeover and Substantial Holding Relief: Discussion Paper* (November 2001).

76 *Corporations Act* s602.

77 This was the case, for example, in relation to the takeover bid by Vanteck (VRB) Technology Corp for Pinnacle VRB Limited.

principles. When they do, it is interesting to note the importance placed on foreign practice. For example, in the leading case in the area, *Advance Bank of Australia Limited and another v FAI Insurances and others*,[78] the Supreme Court of New South Wales saw fit to resort to New York authority to provide guidance on the difficult issue of the ability of an incumbent board to apply corporate funds to influence an election result.[79]

The courts have begun to develop a limited jurisprudence in relation to board conduct in proxy contests.[80] Of particular note is the possible existence of a concept of 'caretaker directors', explored by Owen J in *Woonda Nominees v CHNG*.[81] His Honour cited *Paringa Mining & Exploration Co Plc v North Flinders Mines Ltd*[82] as suggestive of a serious question 'whether there is a principle of caretaker directors in Australian law in the circumstances where a meeting has been called to replace directors.'[83] Under this principle, directors facing a shareholder meeting at which they may be removed from office might be placed in a caretaker role which would constrain them from frustrating the desires of members: particularly the desires of a controlling shareholder or one likely to carry the vote. A positive assertion (repeated in a bidder's statement) that this represents an established bar to the conduct of a target company board in the midst of a takeover was challenged before the Panel in the *Pinnacle 9* case[84] (at the instigation of ASIC). The Panel stated that the 'scant' case law suggested there was 'limited application' for the principle,[85] despite some apparent similarities with the Panel's own decision in the *Pinnacle 8* case.[86]

Most recent court decisions in this area have indicated a broad judicial understanding of the practical imbalance of power between requisitioning shareholders and the incumbent board in proxy contests.[87] In the author's view, we are also here seeing an attempt, this time on the part of the judiciary, to settle upon the most appropriate equilibrium between efficiency and equality: to balance the competing demands of flexibility and responsiveness on the part of the board and the rights of shareholders as residual owners. Once again, we are likely to see international law and practice playing a substantial role in the development of Australian rules.

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78 (1987) 12 ACLR 118.

79 See *Rosenfeld v The Fairchild Engine and Aeroplane Corporation* 128 NE 2d 291 (1955) and *Lawyers Advertising Co v The Consolidation Railway Lighting and Refrigeration Co* 80 NE 199 (1907). The Court also made a referred to an article by Melvin Aron Eisenberg, 'Access to the Corporate Proxy Machinery' (1970) 83 *Harv LR* 1489.

80 See for example *Re DG Brims & Sons Pty Limited* (1995) 16 ACSR 559 and *Kokotovich Constructions Pty Limited & Ors v Wallington* (1995) 17 ACSR 478.

81 (2000) 34 ACSR 558.

82 (1988) 14 ACLR 587.

83 Above n81 at para 51.

84 See *Re Pinnacle VRB Ltd (No 9 & 9B)* (2001) 40 ACSR 56.

85 Id at para 64.

86 *Re Pinnacle VRB Ltd (No 8)* (2001) 39 ACSR 55.

87 See, for example, *Fraser v NRMA Holdings Limited* (1994) 14 ACSR 656 and other cases cited therein.

D. Synthetic Merger Structures

Dual listed company structures (DLCs) have a long and (mostly) distinguished history, stretching back to the late 1920s with the merger of Lever Brothers Limited, Margarine Union Limited and NV Margarine Unie to form the Unilever Group. A similar structure was adopted by the Royal Dutch/Shell Group in 1907. Other examples include the Fortis Group, Nordbanken/Merita, the Dexia Group, Asea Brown Boveri and Reed Elsevier. Indeed, throughout the 20th century, it was the Europeans who pioneered and refined these 'dual headed' structures.[88] Now we must add a separate species of Anglo-Australian DLC, including Rio Tinto, BHP Billiton, and Brambles GKN. Not all DLCs have been successful: several European examples, including Fortis, have subsequently proved unstable and have been unwound.

In many ways, synthetic structures such as DLCs are the natural result of friction between the manner in which globalised business is conducted and the regulatory environment in which it must operate. These structures are, in effect, designed to exploit regulatory arbitrage.

This can be seen at a number of levels. First, and most obviously, is the question of tax. The first real DLC structure, the Unilever Group, was structured so as to avoid the taxation of the Dutch company's profits, which would have resulted had it been placed under an English holding company (the Netherlands at the time had only a tax of 9.05 per cent of profits distributed as dividends). Despite the proliferation of bilateral taxation treaties in recent years, the global regime for the taxation of business enterprises is far from uniform, and discrepancies of the kind driving the Unilever structure, though diminishing, are still common. For example, the first Australian DLC, effecting the combination of CRA Limited and RTZ plc, overcame one of the more significant impediments to scrip based mergers in this country at that time, being the absence of a capital gains tax rollover for selling shareholders. This would otherwise have created a tax impost for CRA shareholders not suffered by RTZ shareholders. Despite the introduction of scrip for scrip rollovers in December 1999,[89] DLCs and other synthetic merger structures can still have compelling tax advantages, including the ability for each entity to maintain its domestic tax domicile, allowing (in the case of the Australian entity) a continuation of a franked income stream. The ability to preserve tax domicile is also critical in jurisdictions which would otherwise levy an effective 'exit tax' on corporations leaving the jurisdictions, as is the position in the United Kingdom.

However, tax alone cannot explain the DLC phenomenon. Other factors, it seems, have also played a part. Among those factors the operation of the international accounting rules and the capital markets objectives of the parties, seem to be the most important.

88 For a description of these structures see Stephen Hancock, Bradley Phillips & Maryse Gray, 'When Two Heads are Better than One' [1999] *European Counsel* (June) at 25.

89 See *Income Tax Assessment Act* 1997 (Cth) subdivision 124M.

Under Australian accounting standards, the ‘purchase’ method of accounting for asset acquisitions is mandated.[90] Essentially, where a transaction can be categorised as an acquisition, the standards require the purchaser to recognise the asset in its accounts at fair value, with any deficiency against the consideration paid recorded as goodwill on acquisition.[91] In turn, goodwill must be amortised pro rata over the expected useful life of the asset.[92]

Of course, the impact of these accounting rules is usually at the reported earnings level, rather than cash flow level, and there are compelling arguments that capital markets efficiently price non-cash accounting effects. There is anecdotal evidence, however, of at least some degree of fixation with reported earnings as a measure of performance, which in extreme cases may be of importance in determining deal structure and viability. Reported earnings can also have a bearing on executive remuneration: on some views, one of the principal drivers of merger activity.[93]

In other cases, the accounting impacts of an acquisition may have cashflow impacts to shareholders, in particular, where amortisation charges impede the acquiring company’s dividend paying capacity. In those cases, the operation of accounting rules may more seriously and directly impact on the structure adopted. Synthetic merger structures such as DLCs and stapled securities may offer opportunities to limit negative accounting impacts. This is another area where we are suffering under a lack of international uniformity. For example, the ‘pooling’ method of accounting for business combinations is still available in the United Kingdom and technically, as demonstrated by the BHP Billiton example, in Australia (at least where there is no ‘acquisition in substance’).[94] In contrast, since 1 July 2001, the United States’ Financial Accounting Standards Board (FASB) requires the adoption of purchase accounting in *all* cases, requiring the participants to recognise as goodwill any surplus of purchase price over the value of assets required.[95] This treatment may inhibit the development of DLCs and other synthetic structures between Australia and the United States (although the absence of mandatory amortisation of goodwill in the latter jurisdiction may still give rise to advantages for more creative structures).

Lawyers are also beginning to see much closer attention being paid to the capital markets implications of M&A activity than was previously the case. This in turn is due to a number of factors, central to which is the concern to ensure the continued access of the merged entity to the deepest and most liquid capital

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90 Australian Accounting Standards Board (AASB), *Acquisition of Assets* Standard AASB1015 (No 1999) at para 6.

91 Ibid.

92 AASB, *Accounting for Goodwill* Standard AASB 1013 (June 1996) at para 5.

93 For a discussion see Nicholas Wolfson, ‘Efficient Markets, Hubris, Chaos, Legal Scholarship and Takeovers’ (1989) 63 *St John’s LR* 511.

94 ASIC, *Financial Reporting by Australian Entities in Dual-listed Company Arrangements* Practice Note 71 (3 October 2001). The question of accounting for DLCs and stapled security structures is presently the subject of a reference to the Australian Accounting Standards Board. See AASB, *Dual Listed Companies: Project Summary* (8 August 2001).

95 See FASB, *Business Combinations* Statement 141 (June 2001).

markets in the world. Indeed, in the author's view, we may be seeing the early signs of a paradigmatic shift in the rationale for merger activity, away from the pursuit of synergies and towards the attainment of capital markets objectives.

This was clearly a major issue for the protagonists in the merger of BHP Limited and Billiton plc early last year. A conventionally structured takeover or scheme, under which BHP scrip was offered in exchange for Billiton scrip, would leave many institutional shareholders in Billiton holding foreign scrip, which was undesirable for a number of reasons (other than taxation). The investment mandates of many UK institutions, for example, expressly limit the percentage of foreign stocks in a particular fund. Acceptance of foreign scrip would also expose the funds to exchange rate risk and, perhaps most importantly, provide limited rights of exit, given the lack of liquidity in the Australian market relative to the London Stock Exchange, even for a prestige stock like BHP. All of these factors contributed to a concern that there would be considerable 'flowback' (selling pressure in the market for the acquiring company's shares) in the event of a conventional merger. A DLC offered a neat way to deal with the capital markets issues, while simultaneously allowing both entities to maintain their domestic residence for tax purposes.[96]

The rapid growth of index funds has also had a considerable impact on domestic takeover activity. As Australian companies vie for the attention of major international index funds, size becomes a critical factor. The desire to preserve or enhance index weightings lay behind many M&A transactions in the last two years, particularly in rapidly consolidating markets such as listed property trusts. Given the absence of synergy benefits in most trust mergers, this consolidation is difficult or impossible to rationalise on synergy grounds, the primary impetus being the desire to minimise cost of capital.[97] As a consequence of increasing market capitalisation, acquisition activity can assist in increasing the free float of securities in a company, which can contribute to index inclusion and a subsequent re-rating of the securities involved.[98] These factors are particularly important in the context of recently introduced changes to the method of index construction to increase the index weighting factor attributed to size of a company's 'free float',[99] which in turn may prompt another round of acquisition activity involving companies with substantial controlling stakes.

All of this poses a number of dilemmas for regulators, particularly in the area of disclosure of financial information. Again, the BHP Billiton merger provides an interesting case in point. The considerable public controversy surrounding that

96 Whether this is possible in any one circumstance will depend on the content of the relevant tax treaty between the top jurisdictions.

97 See, for example, the Explanatory Memorandum to the Homemaker Retail Group's merger with General Property Trust (10 October 2001) at para 3.3.6.

98 See, for example, the takeover bid by Downer Group Limited for Evans Deakin Industries Limited in December 2000.

99 See Standard & Poors' consultative document, *Free Float Proposal for S&P/ASX Indices* (14 December 2001) and press release, *Standard & Poor's Announces Move to Free Float for S&P/ ASX Indices* (15 March 2002).

transaction focused on two aspects of disclosure: the adoption of the 'pooling' method of accounting, notwithstanding what appeared to be an implicit premium paid by BHP to Billiton shareholders under the terms of the merger, and the absence of a independent expert's report in connection with the transaction.

ASIC's approach to the accounting treatment of the BHP Billiton transaction was essentially to work within the existing accounting framework, rather than to use its discretionary powers to waive any substantial requirements of that framework.[100] In the context of synthetic mergers, particularly cross-border transactions, the key regulatory challenge for ASIC is to facilitate, so far as possible, the capital markets objectives of the parties, whilst simultaneously safeguarding the interests of shareholders and other users of financial statements. The subsidiary objective is to ensure that the regulatory regime adopts a 'substance over form' approach, to maintain as far as practicable a level playing field between, one the one hand, parties adopting synthetic merger structures and those adopting conventional acquisition strategies, and, on the other, between in-market mergers and cross-border mergers. For example, if BHP had offered its shares for Billiton shares, it would have recognised goodwill on the acquisition under applicable accounting standards. But as the merger ratio agreed between BHP and Billiton shareholders was 58:42 (respectively)[101] — within the 60:40 guidance provided by the United Kingdom accounting standards body for the availability of pooling — neither BHP nor Billiton was required to account for the transaction as an acquisition. This was despite the market consensus that BHP had effectively paid a substantial premium to Billiton shareholders. Some debate followed both in the press and at a political level as to whether ASIC had successfully adopted a 'substance over form' approach, or whether the converse was the case.[102]

The controversy surrounding BHP's failure to include an independent expert's report on the transaction also demonstrated the important role which the regulator played in effectively 'arbitrating' the claims of competing stakeholders, and to this extent, acting itself as a 'transaction cost engineer'. Had BHP undertaken a conventional scrip bid for Billiton, it would not have been required to prepare an independent expert report. Likewise, there was no requirement for Billiton to prepare such a report. But at the Australian end of the transaction, certain modifications of the *Corporations Act* were required to entrench various governance and takeovers provisions which are viewed as essential to the integrity of a DLC structure. This provided ASIC with the regulatory 'hook' it needed should it see fit to impose conditions on the transaction. There was, at the time, a concerted push by a number of BHP's institutional investors to prompt ASIC to force the company to engage an independent expert to report on the transaction.

100 See Ian MacKintosh, Cth Joint Committee on Corporations and Securities, *Official Committee (Hansard)* (14 June 2001) at CS 85.

101 In a DLC, the 'merger ratio' represents the agreed distribution of economic and voting rights between the two sets of shareholders. It is not to be confused with the 'equalisation ratio', which represents the ratio of per-share economic and voting rights after implementation of the structure.

102 Above n100 at CS89.

These moves were strenuously resisted by BHP: a number of grounds for this objection were advanced (other than that ASIC was seeking what would otherwise not be required), including, implicitly at least, one which devolves at the end of the day to deal protection: such a report may provide justification for an interloper to challenge the transaction. Really, this was another manifestation of the free rider problem created by the structure of our takeovers law.[103] Having expended considerable resources investigating and evaluating the transaction, neither party wanted to see those resources wasted through the actions of an interloper. Hence, ASIC was effectively called upon to achieve a commercial settlement between a number of different constituencies, including BHP and Billiton management, current and prospective investors and potential counter-bidders, at the heart of which lay the very same tension between efficiency and equality. ASIC ultimately manufactured a resolution by requiring BHP to disclose additional financial information, but it did stop short of requiring the preparation of an independent expert's report.[104]

Similar issues are likely to dog the regulator as consolidation in the resources, financial sector and telecommunication and media sectors continues apace. It seems inevitable that, if Australia is to take its place on the world economic stage, both practitioners and regulators will be required to adopt an ever more creative and pragmatic approach to synthetic merger structures.

4. Whither the Eggleston Principles?

Given the pressures which are shaping law and practice in the domestic M&A market, is there any future role for the Eggleston Principles?

In the author's view, serious emasculation of the Eggleston Principles under the most recent round of legislative reform was never likely: the structural characteristics of the regulatory regime were such that politics would always trump principle,[105] as revealed by some flimsy justifications for the final position adopted. For example, although Treasury ostensibly supported the Eggleston Principles on efficiency grounds, as essential for the maintenance of 'investor confidence' in the operation of the capital market,[106] that argument is somewhat disingenuous as the linkage between market confidence and economic efficiency is tenuous.[107] The more credible explanation for the retention of the Eggleston Principles lies in expediency, which is entirely consistent with Roe's 'political paradigm', applied to the local M&A regime.

It should be noted, of course, that Australia is not alone in adopting a general principle which requires equal treatment of all offerees in a target company. General Principle Number 1 of the *City Code* states that 'all shareholders of the

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103 Above n63 and related text.

104 See ASIC, *BHP agrees to make additional disclosure on Billiton dual listing* Media Release 01/145 (4 May 2001).

105 Above n14.

106 Above n4 at para 9.

107 Above n62. See also Lawrence, above n38 esp at 181–190.

same class of an offeree company must be treated similarly by an offeror'. However, what is unique about the operation of the Australian provisions is the rigidity of the implementation of that general policy and the point of a transaction at which potential offerees are thrust into a public auction for control. While the *City Code* allows a bidder to move through the 30 per cent takeover threshold, provided this is followed by a 'mandatory bid'[108] extended to all other holders on the same terms, the offeror for an Australian company cannot acquire control of a parcel of more than 20 per cent, except *pursuant to* a general offer. Recent legislative reform proposals for the introduction into Australia of a mandatory bid rule or some similar mechanism were scuttled in the Senate. Accordingly, minority shareholders in Australia tend to be empowered to a far greater extent than in the United Kingdom.

Attempts to introduce a 'watered down' version of the Eggleston Principles into the European Parliament have recently been frustrated. The proposed *European Parliament and Council Directive on Company Law Concerning Takeover Bids*[109] faltered after opposition from the German members of the European Parliament. The directive would also have embodied the concept of equal treatment of all holders of securities of an offeree company.[110] However, it would also have included an equivalent of the mandatory bid rule and a general prohibition on defensive conduct, both very similar in operation to the *City Code*. Together, these changes would have represented a substantial liberalisation of the takeover regimes in several European jurisdictions, particularly in Germany where (at least until Vodafone/Mannesmann in 1999) hostile acquisitions were practically unheard of.[111]

The market for corporate control in the United States has been influenced by the development of state-based rules of corporate law (which range from the permissive philosophy of Delaware to the stakeholder-oriented philosophy of California) within the context of federal securities laws which predominantly employ rigorous mandatory disclosure and procedural requirements as restraints upon the agency problems inherent in the corporate contract.[112] In the context of control transactions, additional rules on disclosure and procedures are imposed by section 14(d) of the *Securities Exchange Act 1934* (USA) (sometimes referred to as the *Williams Act*).[113] These include a 'weak form' of the Eggleston Principles under which guarantees to each shareholder in a tender offer class the opportunity to participate in the offer at the best price paid to any other shareholder (similar, in effect, to the mandatory bid rule under the *City Code*).

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108 *City Code on Takeovers and Mergers* Rule 9.

109 See European Council, *Thirteenth European Parliament and Council Directive on Company Law Concerning Takeover Bids* Common Position (EC) No 1/2001 (19 June 2000). See also subsequent European Parliament legislative resolution A5-0368/2001 (13 December 2000).

110 *Thirteenth European Parliament and Council Directive on Company Law Concerning Takeover Bids* article 3(a).

111 See above n24.

112 Paul Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62 *UChiLR* 1047.

113 The *Williams Act* 1968 (USA) (15 USC §§78m(d)–(f) and 78n(d)–(f)) was enacted as an amendment to the *Exchange Act* §§13(d)–(e) and 14(d)–(f).

In some important respects, therefore, the Australian law remains somewhat at odds with other developed regimes: perhaps we are best described as lying somewhere between the United Kingdom and continental Europe. Like the United Kingdom, we tend to share a disdain for management entrenchment through overtly defensive conduct by target companies, but like continental Europe, we make life unusually difficult for putative bidders. In Europe, much of the difficulty lies not with law but with the structure of governance mechanisms. But here, the explanation is more direct: our laws prohibit private control transactions.

Can this *sui generis* position be sustained? In the author's view — to use the capital markets terminology — the trend is probably against the Eggleston Principles. For the practicing lawyer, the challenge under Australian M&A law is increasingly how to achieve a maximum degree of transaction certainty within an environment which does not allow for private control transactions. Given the characteristics of our local market, the weakness of our currency and our dependence on foreign capital flows, it seems likely to the author that the pressures for convergence will eventually prove too great to resist. We will inevitably trend towards the dominant paradigm, and that is one which has as its core the pursuit of economic efficiency. And while legislative trends in this area may exhibit a high degree of path dependence, the unique devolution of policy formulation in this jurisdiction to ASIC and the Panel provides much greater scope for a gradual, 'functional' convergence.[114]

To some extent, for example, the Panel's more permissive approach to break fees might be seen as a 'consolation prize' for the Parliament's rejection of the mandatory bid rule in Australia. While, as noted above, a break fee probably cannot be employed in such a way as to materially increase deal certainty (for the risk of being declared 'unacceptable') as it can (possibly) in the United States, it can at least compensate a losing participant in the auction for its reasonable costs. As practicing lawyers, we would therefore expect our clients to continue to pressure us to push the limits of acceptable break fee arrangements both in terms of quantum and triggers. Likewise, we would expect to see increased use of other deal protection mechanisms such as 'no-shop' and 'no-talk' agreements, stock options and collateral benefits. These efforts are aligned to the objective of enabling private control transactions despite the offensiveness of that concept to the Eggleston Principles.

In the author's view, this adaptation process will eventually lead to a situation in which the jump from the current law to a position closer to the *City Code* (including the equivalent of a mandatory bid rule) is rendered sensible and far more politically palatable.[115] But we are clearly not at that point yet, and at least two other plausible scenarios must be admitted.

This first is that the legislature, courts, ASIC and the Panel continue to refine their views on matters such as deal protection, proxy contests and synthetic merger

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114 See also Coffee, above n19 at 679–682 for a similar perspective in the United States context.

115 See the detailed consideration of the Israeli experiment in formally converging listing requirements with the United States, in Licht, above n27.

structures, by reference to the Eggleston Principles but also in such a way to align, as closely as practicable given local conditions, the operation of local law with that in major foreign jurisdictions. Under this scenario, convergence between our local law and practice and that of foreign markets would continue, with a twist. The twist would come with the sorts of conditions as are imposed on exercises of judicial or administrative power. They may have the result (indirectly) that private sales of control are 'tolerated' or facilitated in limited circumstances, for example, where preceded by an effective 'private' auction process.[116] ASIC's flexible approach to DLC accounting and disclosure issues, including in the context of the BHP Billiton DLC, can also be seen as an example of this approach, which may allow us to preserve the fundamental 'Australianness' of our takeovers laws with only a marginal impact on efficiency.

In the second alternative scenario, the Eggleston Principles continue to be entrenched and rigorously enforced at a judicial and administrative level. In the author's view, this approach is normatively undesirable, but positively unlikely. Continued substantive divergence with international norms potentially puts at risk the foreign capital flows on which this country depends so heavily in order to secure its future. However, we have seen, in the aftermath of FIRB's refusal of Royal Dutch/Shell's bid for Woodside, the Government's acute sensitivity to this problem, which is probably (assuming a relatively direct relation between the level of foreign capital flows and domestic political imperatives such as increased employment) sufficient to make divergence politically unattractive. As in areas such as taxation and competition law, in M&A, it seems to the author that we pursue an agenda of divergence with international practice at our peril.

5. Conclusion

Given the level of activity in the domestic takeover market in recent years, it is very easy to lose sight of the fact that, our market represents a mere drop in the ocean in global economic terms. However, this is the reality which we must face in an increasingly globalised environment. If Australia is to remain attractive as a destination for foreign capital, it is important that our takeovers laws not diverge too far from the international norm. The search for potential acquisition takeovers is a costly activity and the need to deal with the multiplicity of regulatory issues will only exacerbate those costs.

At the same time, our takeovers laws embody a concept of equal treatment and protection of minority shareholders which is uniquely Australian in its orientation. In the author's view, it may well be possible to pursue convergence without completely abandoning that concept. In so doing, the Eggleston Principles may continue to have a role in a globalised M&A environment.

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116 The Panel's decision in the *Alpha Healthcare* case (above n60 esp at paras 25–29) provides an excellent example. In that case the controlling stake (which comprised debt and equity) had been extensively 'marketed' by the receivers of the holder in what the Panel thought 'constituted a better test of the market for the Alpha shares than happens in many takeovers which are notionally more open to a competing bid'.