Australian Council of Super Investors Inc.

IMPLICATIONS OF DUAL-LISTED COMPANIES FOR THEIR SHAREHOLDERS

SUMMARY AND OVERVIEW OF PAPER PREPARED BY SEK Hulme AM, QC

Author's Summary to the Paper

The DLC structure did not emerge in Australia pursuant to Parliamentary enactment providing for it, following public and commercial and academic and Parliamentary debate as to the need for it, its possible advantages and disadvantages, its possible implications for shareholders or the nation, and the terms upon which we should have it, if we were to have it at all. It was devised by the legal advisers to large corporations, without any debate whatsoever of those kinds. It was devised within a legislative structure intended for a different purpose, and the creators of which had never envisaged it bringing forth such a creature as the DLC.

To date there has been in Australia no expression of disquiet or even of a need for caution, from either governmental or supervisory bodies. Parliament seems not to have adverted to the matter, and supervisory bodies co-operated in the very creation of the DLC structures. To enable the BHP-Billiton DLC structure to be adopted in Australia, the Australian Securities and Investments Commission gave dispensations with respect to not less than 160 provisions of the Corporations Act.

The DLC structure does in fact give rise to difficulties and disadvantages. Several of these are considered in the paper. It will be seen that the DLC structure goes flatly contrary to the policy which legislatures have been following, of strengthening the ability of shareholders to maintain some control of boards and management. No corporate development in the last hundred years has done more than the DLC structure has done and promises to do, to weaken the position of shareholders and entrench the position of board and management.

There is nothing in principle to prevent the creation of a DLC structure involving three or more companies and countries rather than two, or involving two or more corporate cultures and languages rather than one. Each extra company, country, culture and language would entrench board and management still further. The board and management of a corporate group that set up say a four-company four-country multi-language QuadrupleLC structure would be as far from being effectively answerable, either by way of shareholder challenge or by way of takeover challenge, as a board and management could wish.

It is necessary and urgent, that Parliament and commerce and academia and the public give the fullest consideration to the DLC development, examining the structure's advantages and disadvantages, and deciding whether the structure is to be permitted, and if so on what terms, and that Parliament should amend and add to the Corporations Act accordingly.

The writing of this paper involved a five-months search to ascertain the full list of the amendments and modifications to and exemptions from provisions of the Corporations Act which the Australian Securities and Investments Commission had made in respect of the BHP Billiton companies. ASIC

was at no time prepared to confirm, and to this day continues to refuse to confirm, that the amendments and modifications and exemptions which have painstakingly been tracked down are all that ASIC has made. It is surely intolerable that ascertainment of the effective content of the laws enacted by the Commonwealth Parliament should require such effort and delay, and end in ultimate uncertainty.

OVERVIEW OF THE PAPER

This overview is *not* intended as a substitute for reading the full paper. It is no more than an outline, indicating certain of the material to be found there. Please read the full paper before arriving at any views on the matters dealt with.

I. INTRODUCTION

The author has relied on the DLC arrangements relating to BHP Billiton for the purpose of reviewing the potential difficulties and issues that impact on shareholders under dual listed company arrangements.

The terms AusCo and UKCo are used in the paper to indicate imaginary companies operating under documents identical with the BHP documents.

References to the BHP Billiton companies are to BHP Ltd and Billiton plc in their pre-DLC days and BHPB Ltd and BHPB plc since the creation of the DLC structure.

There has been little public discussion of the DLC development, either here or in England. Little has been said as to the implications of the DLC structure for the relationship between shareholders and board in relation to the control of the companies comprising a DLC.

The paper primarily seeks to identify what features of the DLC structure might materially weaken the ability of shareholders to discipline non-performing boards or might have the effect of entrenching board and management or inhibit takeovers. From this there may emerge in future proposals for changes to the structure, to counteract those risks.

This paper is concerned with the operation and effect of the structure as regards corporate governance and shareholder control and national control rather than commercial consequences.

At the same time it notes that of the 11 DLCs created since 1988, 6 have already been terminated after lives of 11, 8, 4, 3 and 2 years. The five remaining include a UK-Holland DLC founded in 1988, the three UK-Australia DLCs namely Rio Tinto (1995), BHP Billiton and Brambles (both 2001), and a UK-Panama DLC established earlier in 2003. One of these five survivors, Brambles, is already being spoken of as a takeover target.

The paper examines how the provisions of the DLC structure works particularly in relation to certain specific situations:

- The election of directors
- The removal of directors
- Schemes of arrangement
- Takeovers
- Winding up

- The increased power of directors in DLCs.

The paper then says a little as to more general problems:

- Problems of dissimilar company regimes,
- Problems of dissimilar company cultures,
- The possibility and effect of treble or quadrilateral listed structures.

The paper concludes with a critical account of the difficulties encountered in ascertaining the orders made by ASIC to modify the Corporations Act in relation to the BHP Billiton companies, to facilitate the creation and operation of the BHPB DLC.

II. THE DLC STRUCTURE PRINCIPLES

Explaining how the DLC provisions work is no easy task. The provisions are extremely intricate, they make unfamiliar assumptions, and the difficulty of coming to grips with them is heightened by the unhelpful terminology in which they have been cast.

One assumption upon which central provisions of the DLC arrangement rest, is that it is possible for the board of a company to function in a proper manner on the basis of considering and bringing to account the interests of two separate bodies of members, one in its own company, and one in another. It is true that under a DLC structure those interests will, in many circumstances, be identical. But this will not always be so. The interests of the two bodies of members *can* diverge: can indeed be diametrically opposite.

Because neither DLC structures nor DLC problems have ever been considered by the Parliament, the Act contains no such rules. Neither do the DLC documents give guidance. The matter is simply left to the board – the members of which, it must be borne in mind throughout, constitute the board of both companies. And different members of the board will have significant financial interests – in some cases very significant financial interests indeed – usually in one or other of the two companies, not in both.

The paper refers to the spin-off of BHP Steel Ltd by BHPB Ltd to the shareholders of BHPB Ltd as such an example. The question of the size of the compensating issue of bonus shares in BHPB plc to be made to the members of BHPB plc raised a question on which the two sets of members had directly opposing interests. Neither the Act nor the DLC documents provided any guidance. All was left to the judgement of directors.

Again, all rules prescribed by the Constitution of BHPB Ltd as to the voting procedures to be followed in relation to specific subjects are themselves subject to the further discretion of the board. The Constitution of BHPB Ltd gives the board of AusCo power to decide that a resolution which would otherwise be a Class Rights Action requiring the assent of the shareholders of UKCo shall be treated as a Joint Electorate Action, putting the matter to a joint vote of the members of the two companies voting together; similarly the board has power to decide that a resolution that would otherwise be a Joint Electorate Action putting it within a joint vote of the members of the two companies voting together, shall be treated as a Class Rights Action requiring the assent of the members of UKCo. No guidance is given anywhere as to the criteria to be used in the exercise of these discretions.

Equalisation Principles

The Equalisation Principles are found in provisions described in the paper as "at best laconic", and "at worst defective" in a number of ways. It is unfortunate that so fundamental a provision should yield any clear meaning so reluctantly.

The underlying idea of the Equalisation Ratio is to achieve fairness as between the members of the two companies. Yet what the literal words of cl 3.1(a) in the DCL Sharing Agreement say, is that *when the Equalisation Ratio is 1:1* the holder of a AusCo share and the holder of a UKCo share shall "as far as practicable receive equivalent economic returns" and "enjoy equivalent rights as to voting in relation to Joint Electorate Actions". The clear implication is that when the Equalisation Ratio is *not* 1:1, the shareholders will *not* receive equivalent economic returns. That is in fact the opposite of the intention. The reason why the Equalisation Ratio moves off 1:1, if it ever does so, is to ensure that in the events which have happened there continues to be an equivalent return.

The definition tells us that the *Equalisation* Ratio "means" the ratio for the time being between the economic rights and voting rights attaching to shares in the two companies. Certainly one can find the current Equalisation Ratio by seeing what is currently being done with dividends. But what *determines* the Equalisation Ratio is human decision by the Board.

The initial Equalisation Ratio presumably depended on the assets each company brought into the DLC, the values attributed to those assets as agreed by the two companies, and the number of shares in each company carrying the right to the assets of that company. As to all this the Sharing Agreement says absolutely nothing.

The Sharing Agreement provides that where a proposed Action in one company would result in the ratio of the economic returns on a share in either company as compared with a share in the other company being other than the current Equalisation Ratio – which means that, the new economic investment per share in that company would differ from the existing economic investment per share in that company - a Matching Action shall be undertaken in the other company, unless the directors consider that course not appropriate or practicable. Where the directors consider a Matching Action not appropriate or practicable, an "appropriate adjustment" is to be made to the Equalisation Ratio to maintain equivalence of economic return.

In consideration of the above, the board in summary has to determine:

- The values of asset changes relevant to the Equalisation Ratio;
- Whether it is appropriate to have a Matching Action;
- Whether it is appropriate to make an adjustment to the Equalisation Ratio;
- What that adjustment shall be;
- Whether the effect of the Action is or is not material;
- What the voting regime shall be if the matter is put to a vote of shareholders.

These are wide powers indeed, and their exercise cannot effectively be challenged.

The basic position in relation to voting is that where the members of both companies are to vote together the voting power per share is to follow the Equalisation Ratio as existing from time to time. No separate difficulty arises in relation to that.

III. THE DLC VOTING STRUCTURE

The paper observes that in general, corporate arrangements recommended by directors and affecting the exercise by members of their voting rights need to be scrutinised with sceptical care.

This scepticism is further compounded given that the paper identifies that a clear understanding of the voting structure of the DLC is difficult to attain, for the provisions are extraordinarily complex.

The foundation for it all is to be found in the Sharing Agreement. The DLC structure Sharing Agreement provides for a mechanism of a "Parallel General Meeting" in which the parties are required to convene as necessary, to ensure so far as possible that when a resolution is to be put to a general meeting of one DLC company, a meeting of the other company will consider a similar resolution as nearly as practicable at the same time. References in the Constitution to an "equivalent" resolution being submitted, lack any specificity. Whether any different meaning is meant than "parallel", is not clear.

As mentioned above, the Constitution confers on the board of the company wide powers to modify the application of these rules with regard to Joint Electorate Actions and Class Rights Actions.

The DLC Principles will require that boards must call meetings of both companies in order to cope with a situation presently arising in only one of them.

IV. THREE GENERAL PROBLEMS

A. STATUTORY QUALIFICATIONS BY REFERENCE TO VOTES

A number of provisions of the *Corporations Act* give particular rights to shareholder groups of a certain size, and some of these do so by reference to votes which can be cast at a general meeting. Thus s 249D(1)(a) provides that the directors of a company must call a general meeting on the request of "members with at least 5% of the votes that may be cast at the general meeting".

The DLC structure alters this dramatically. Assuming the DLC companies to be of equal size, the number of votes which can be cast at a meeting of one DLC company is doubled, to bring in votes as cast in the other company. To have 5% of the *votes* which can be cast in one company, one needs to have 10%, not 5%, of the *shares* in that company. If holders of 5% of the shares in BHPB Ltd wish to requisition a general meeting, and the holders of 5% of the shares in BHPB plc likewise wish to do so, they are unable to do so. What will be required are the holders of 10% of the shares in both companies. The legislative requirement in each country has effectively been doubled.

B. SOME DIFFICULTIES OF DISTANCE AND COST

Where a matter falling for the Joint Electorate Procedure is disputed by members in one company, they will be at very significant disadvantage compared with members involved in a similar dispute in a company wholly within Australia. One half of the effective electorate consists of members of another company, 13,000 miles away. The paper suggests that a challenge involving an Australian end and a London end of a DLC would cost something like five times what a similar challenge would cost if fought wholly within Australia. And there would be practical difficulties in connection with the financial Press. Thus a matter of great interest in one country may be seen as quite unimportant in the other, making ventilation of the issues extremely difficult.

C. VALUATION, THE EQUALISATION RATIO, AND BHP STEEL

The spin-off of BHP Steel to the shareholders of BHPB Ltd clearly operated to reduce the economic investment per share thereafter represented by a share in BHPB Ltd. That called for some kind of matching action in BHPB plc. That involved calculating the extent of the reduction in economic investment per BHPB Ltd share. One would have thought that the method used to calculate this reduction would march with the method used to put a figure on those assets on their way *into* the DLC structure, when their value was contributing to the economic investment per share in the BHPB Ltd as originally calculated.

Shareholders have never been told what that method was. The figure taken as the reduction of economic investment per share was calculated from the stock exchange price of shares in BHP Steel after spin-off. On no view was that the method used to put a value on the BHP Steel assets on their way into the DLC structure. Only by coincidence could the method used by the board have produced the correct figure.

V. ELECTION OF DIRECTORS IN A DLC

Difficulty would arise in an election if a person were proposed as a director of one of the companies but not the other, as could happen if there were dissension in the ranks of the members. The initiating members in AusCo would not, in that capacity, have power to put on the agenda of UKCo a proposal for the election of a person as a director of AusCo, and still less a proposal for the election of the person as a director of UKCo.

Any movement to install a director unwelcome to the incumbent board is going to face very considerable difficulty and uncertainty.

VI. THE REMOVAL OF DIRECTORS OF DLC COMPANIES

If a director were removed from the board of AusCo, the two boards would be differently composed unless the director were removed also from the board of UKCo. That would require a quite separate resolution, though one in parallel purpose. As no group of members of AusCo would, except by investment coincidence, have standing to bring about a meeting of UKCo, or to propose a resolution there, the initiating members will often be unable to do anything to initiate that further resolution.

Faced with the request from the initiating members, and notice of their resolution, the directors of the two companies could be seen to come under duty, from multiple sources, to do all that could lawfully be done to prevent the two companies having different boards. This might include failing to call a meeting of UKCo, thereby causing the challenge to come to nothing. Again there seems nothing to guide the directors as to what to do.

The paper observes a demonstration of one of the very real challenges that the DLC structure provides to members and their advisers, namely the sheer difficulty of ascertaining just how the DLC provisions operate alongside a *Corporations Act* built on a different basis.

VII. THE DLC AND SCHEMES OF ARRANGEMENT

Schemes of arrangement of Australian corporations are governed by the *Corporations Act*. Their adoption involves a large cast, always including directors, ASIC, and the court, as well as members or creditors or both, or various classes of them, according to the nature of the proposal.

It is normally the company which brings a proposed scheme forward.

The decision to seek a scheme will be that of the directors, it will be made pursuant to DLC principles. The result is to make it improbable that any scheme will be brought forward in one company unless it is practicable for a matching scheme or at any rate some matching Action to be brought forward in the other. In these circumstances it is surprising that the DLC structure documents say nothing whatever as to schemes.

VIII. THE DLC AND TAKEOVERS

The threat of takeover presents the ultimate challenge to boards, with other persons in effect asserting that they can manage the company's assets better then the board can.

Elaborate provisions to control takeovers are built into the constituent documents of each DLC company. They are designed to ensure that subject to one qualification, the only takeover proposal that can proceed is a takeover of both companies at the same time.

The qualification is that the board has the power to allow *any* takeover offer to proceed if it thinks fit, notwithstanding that it does not comply with the rules set out in the Constitution. Again no criteria are prescribed as to exercise of the discretion.

Thus a hostile takeover offer can come only from a bidder willing to make offers in two different countries, under two different legal systems prescribing two different statutory procedures. The bidder must be willing to obtain legal advice and activity in two countries, and to accept the risk of being involved in legal proceedings in two countries, quite likely at the same time. The paper predicts that it is likely to be a very long time before a hostile bid for a DLC company is seen: and longer still before there is a second.

On the other hand, with the approval of the board a takeover offer can be made on different terms. Thus there is created room for the emergence of the takeover offer *approved by the board being challenged*, without likelihood of competition from anyone else.

It is obvious that difficulties of the kind just mentioned would be greater in the case of a DLC involving Australia and almost any country other than England, and still more so if there were a multi-country DLC.

The result is that to a very considerable extent the DLC structure removes the last great challenge an incumbent board can face, that other people think they can manage the company's assets better than the incumbent board can.

IX. THE DLC AND WINDING-UP

The passing of any resolution for winding-up will be influenced by the wishes of the members of UKCo, under the Joint Electorate Procedure of the Class Rights Actions Procedure.

The decision whether AusCo is to enter into voluntary winding up will be made not by the members of AusCo, but by the members of UKCo, under the Class Rights Actions Procedure.

One cannot but believe that the intention was to bring into the Class Rights Action Procedure *all* resolutions of members for the winding up of the company. If so the draftsman seems to have missed fire, for he does not cover a resolution of members under s 461 of the Corporations Act, that the company be wound up by the court. The voting procedure to be applied for such a resolution, is not spelled out anywhere in the BHPB Ltd Constitution. But the result of that is – as usual – that the voting procedure will be the one elected by the Board. One would expect the board to pick the one most suited to its own preference as to what the decision should be.

X. THE DLC AND ENTRENCHING THE POWERS OF DIRECTORS

In summary, the DLC structure affects the powers and position of the directors in the following ways:

1. Power to amend the objects of the company, via power to amend the DLC agreements which the directors have power to and indeed are bound to give effect: see rule 84 of the Constitution of BHPB Ltd.

2. The leeway and protection given by the fact that nothing the directors do in good faith in giving effect to the DLC principles or in amending the DLC agreements under (1) shall constitute a breach of fiduciary duty to the company.

3. Power to determine, with no criteria enunciated for making a determination, whether any issue is to be decided as a Joint Electorate Action or as a Class Rights Action.

4. Power to decide what is to be done when the two groups of members have competing interests, and to do so without any criteria.

5. Power under the Sharing Agreement and the related company documents to determine whether to have a matching action in the other company, or to make some Equalisation Ratio adjustment in the other company, and power to determine the values at which that is to be done.

6. Power to determine whether the effect of an Action is immaterial and not to be counterbalanced by a matching action or adjustment.

7. The fact that the DLC structure raises the hurdle dissentient shareholder groups must surmount in order to attract the assistance of the Corporations *Act*, thereby making challenge more difficult.

8. The practical difficulties in addressing one half [if the two companies are of equal shareholder size] of the persons who in the ultimate control the votes to be cast within AusCo, again inhibiting challenge.

9. Power to decide what assistance if any to give or not give to dissentient shareholder groups forced by the DLC structure to address persons not members of their own company.

10. Power to decide whether or not to allow the making of a takeover offer not falling within the normal rules of a Permitted Acquisition.

11. Power to determine whether the members of AusCo and the members of UKCo together, or the members of UKCo alone, are to have the final say on whether AusCo shall apply to the court for an order that AusCo be wound up.

XI. A GLANCE AT THE FUTURE

The difficulties for a legislature seem obvious, of controlling the affairs of a commercial group which has no ultimately controlling group of members, but has say four different groups of shareholders in four different countries, some possibly speaking different languages, and in three of which the legislature's fiat does not run. The difficulties seem obvious, of expecting courts to determine the proper weight to be given to persons who though not members of the company before them, are persons with closely related commercial interest. As noted earlier:

> There is nothing in principle to prevent the creation of a DLC structure involving three or more companies and countries rather than two, or involving two or more corporate cultures and languages rather than one. Each extra company, country, culture and language would entrench board and management still further. The board and management of a corporate group that set up day a four-company four-country multi-language QuadrupleLC structure would be as far from being effectively answerable, either by way of shareholder challenge or by way of takeover challenge or by way of national control, as a board and management could wish.

XII. AN ADVENTURE IN FINDING THE LAW

Parliament and political correctness have joined in making the *Corporations Act* so complex and in places so impractical and contradictory that it has been found necessary to empower the Australian Securities and Investments Commission to make orders amending or modifying or exempting from provisions of the Act, in their application to designated companies.

What is done, when such powers are exercised, is to alter the public law of the Commonwealth in its application to these companies and other persons having dealings with them.

The paper narrates with some relish the difficulties encountered in ascertaining what orders ASIC made in respect of the BHP Billiton DLC: even including an e-mail to the chairman of ASIC, Mr David Knott, addressed as instructed DavidK@asic.gov.au being returned "DavidK(DavidK@asic.gov.au) not listed in the public Name and Address Book". At a time when it has in fact made at least 12 orders, with something like 48 sub-orders, affecting the operation of something like 160 provisions of the Corporations Act, ASIC stated that it had made *none*. A little later, when it had made 14, the reply to an inquiry made to BHPB Ltd disclosed *none*. Only slowly and painstakingly did the facts emerge. To this day ASIC refuse to confirm that the orders which have been located are *all* that it has made.

It is essential to the rule of law that material of this kind be available on request, and that proper systems should exist to make it possible not only to give notice of all orders of which an officer is aware, and the text of them, but also to be able to say that that is all there are.

You are again, and earnestly urged to read the full paper.