

GETTING A GOOD BUY WITH A LITTLE HELP FROM A FRIEND: TURNING TO THE UNITED STATES TO GO FORWARD WITH AUSTRALIAN TAKEOVERS REGULATION

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ABSTRACT

Australia has always turned to the United States for guidance and inspiration. We appreciate U.S. fashion, take a strong interest in U.S. politics, and are heavy consumers of U.S. film, television shows and music. But in relation to U.S. corporate regulation and corporate law scholarship, Australia is decidedly slow on the uptake. It would be wrong to suggest that Australia does not follow what is going on in the U.S. corporate law arena, particularly since the collapse of Enron and WorldCom, but it hasn't excited us. Like much that comes out of the U.S., the great nation of liberty's corporate law scholarship and approach to corporate regulation can generally be described as brilliant.

In this article, I tap into this brilliance in an attempt to unlock the hidden genius of Australian takeovers law. It is argued that the regulation of Australia's market of corporate control can be made more efficient not through the conventional process of law reform, but rather through a fresh approach to corporate regulation (and more specifically takeovers regulation) involving the application of principles of marketing and product design. A trip to the other side of the world reveals a lot about Australian takeovers law that most observers do not appreciate. It is well worth the plane ticket.

Re-examining Australian takeovers regulation through a U.S. lens is not of mere academic interest. Nor is it merely a topic of interest to Australians. In fact, Australia has the strongest takeovers market in the Asia-Pacific region (excluding Japan), and has one of the most active takeovers market in the world. The Australia-U.S. Free Trade Agreement, which came into effect at the beginning of 2005, also makes it a lot easier for U.S. corporations to invest in Australia, making Australia a more attractive opportunity for U.S. investors. It is therefore important that Australian takeovers law, an important product in the market for corporate control in Australia, is designed so as to be

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as efficient as possible.

This article is about effective product management of Australian takeovers regulation, drawing upon ideas and thinking in the U.S., to make it a more attractive product going forward.

In this article, I explain how a mix of U.S. ingenuity and Australian vision can achieve greater freedom for participants in Australia's market for corporate control.

INTRODUCTION

Purpose of the Article

The idea behind this article is to unlock the hidden "genius" of Australian takeovers law.¹ This is to be achieved not by way of legislative reform, but rather by taking a fresh look at the law which already exists, in light of the structure of U.S. takeovers law and innovation in U.S. corporate law scholarship, along with the use of principles and concepts in marketing.

It will draw upon the U.S. economic analysis of law and corporate law; more specifically, treating law as a product in a market. Accordingly, this makes it useful to draw upon principles of marketing to make the product more effective in responding to consumer demand.

This article will adopt a "product management approach" to takeovers law, seeking guidance from the U.S. to make the product more efficient, in order to respond to consumer demand and thus to justify the continued existence of this product in the market. In doing so, it will look to the regulation of takeovers in the U.S., a system which has similar objectives to Australian takeovers regulation but which is more streamlined, despite operating in a more sophisticated and active market for corporate control.

The approach of this article has strong parallels with a famous statement of former U.S. President John F. Kennedy, "[c]itizens of the world: ask not what America will do for you, but what together we can do for the freedom of man."² This article is about how applying American thought and practice to the existing structure of Australian takeover law will provide for greater freedom, and overall greater efficiency in the operation of Australian takeovers regulation.

1. ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993) (in using the word "genius" the author draws inspiration from Roberta Romano's famous monograph).

2. U.S. President John F. Kennedy, Inaugural Address (Jan. 20, 1961), available at <http://www.hpo1.org/jfk/inaugural> (last visited Nov. 28, 2006).

Learning from the United States: It Must Be Doing Something Right

As Tom Cruise's character said in *Jerry Maguire*, "America sets the tone for the world."³ Notwithstanding recent talk of a slippage in U.S. dominance and influence, there are factors which will ensure that the U.S. sets the tone for a long time to come.

It makes sense for this article to focus on the U.S. The U.S. has the largest economy in the world; indeed over one fifth of the world's gross domestic product (GDP) occurs in the U.S.⁴ More specifically, the U.S. is also home to the largest and most successful corporations in the world, and also has a very healthy mergers and acquisitions (M&A) market. Part I of this article will look at the statistics that confirm the dominance of the U.S.

Thus, as a producer of corporate law, the U.S. is a successful operator. Australia, in developing its product for offer in an emerging region for M&A activity, could do a lot worse than turn to the U.S. for guidance in relation to corporate regulation, and takeovers law in general. It is time for Australia and its corporate regulator, the Australian Securities & Investments Commission (ASIC), to be inspired and get excited about corporate regulation.

The Global Importance of Australia's Market for Corporate Control

This article is not simply about focusing on the takeover rules of a jurisdiction that is a nice place for a holiday, but does not really have much practical importance. While I understand as well as anybody that it is useful to know about what is going on in another jurisdiction, pragmatism dictates that one's time is better spent learning more about the rules in one's home jurisdiction.

But this is not the case in relation to Australian takeovers law. Australia is the busiest M&A market in the Asia-Pacific region (excluding Japan), and rates highly in international foreign direct investment (FDI) confidence surveys. Americans are the biggest investors in Australia, and this trend is only going to continue due to the recently-enacted free trade agreement, which (among other things) liberalizes foreign investment rules between the two countries. In terms of M&A, more American eyes will inevitably turn to Australia.

Below is a summary of some useful recent statistics on Australia.

3. *Jerry Maguire* (Tri-Star Pictures 1996).

4. Yahoo!, World Factbook: GDP Statistics Country Comparison Table, http://education.yahoo.com/reference/factbook/countrycompare/gdp/la.html;_ylt=AouSSu4K0UTwbu2jBYLFNLGecYF (last visited Dec. 7, 2006).

Australian Economy

Australia is the fourth largest economy in the Asia-Pacific, and the fourteenth largest in the world. According to the World Competitive Yearbook, Australia has the third lowest level of political instability in the world. Furthermore, according to the Economist Intelligence Unit, Australia is the sixth best place to live in the world; the only non-European country in the top ten.⁵

Australia's M&A Market

According to the KPMG Corporate Finance survey of the Australian takeovers market for 2004 and 2005, Australia is one of the top three active M&A markets in the world, and the largest in the Asia-Pacific region, excluding Japan. Furthermore, according to the KPMG survey, Australia is currently experiencing an aggressive M&A market. From 2004 to June 2005, M&A activity was up 55%.⁶

Australia is home to approximately 4% of the worldwide M&A market. According to KPMG, in 2005, \$27 billion (USD) worth of deals were done in Australia, out of \$671 billion (USD) worth of deals worldwide.

In a paper published in 2002, M&A lawyer Justin Mannolini explained that, “[a] stable political system, independent judiciary, reliable money supply and recognition and protection of property rights are all critical” – making Australia a potentially important M&A destination, even though it “has an extremely small capital base by world standards.”⁷

Foreign Direct Investment in Australia

According to A.T. Kearney's 2004 FDI Confidence Index survey, Australia ranked as the “seventh most attractive destination in the world

5. AMERICAN AUSTRALIAN ASSOCIATION, US – AUSTRALIA FREE TRADE AGREEMENT <http://www.americaaustralian.org/Services/storyprint.php?storyId=2028&type=story> (last visited Nov. 28, 2006).

6. Note, however, that according to the December 2005 edition of Australia's *Corporate Law Electronic Bulletin*: “The value of mergers and acquisitions (M&A) in Australia dropped by 19 percent in 2005 compared to the same period in 2004, according to research by KPMGs Corporate Finance practice published on 5 December 2005. While the number of deals rose slightly from 612 in the first 11 months of 2004 to 651 in the first 11 months of 2005, the value of deals fell substantially from \$61 billion to \$49 billion over the same time frame.” CORPORATE LAW ELECTRONIC BULLETIN, available at <http://cclsr.law.unimelb.edu.au/go/corporate-law-bulletin/> (last visited Nov. 28, 2006).

7. See Justin Mannolini, *Convergence or Divergence: Is There a Role for the Eggleston Principles in a Global M&A Environment?*, 24 SYDNEY. L.REV. 336, 342 (2002).

2006] **Applicability of U.S. Takeovers Laws in Australia** 157

for foreign direct investment.”⁸ American and British investors accounted for more than half of the FDI investment in Australia.⁹

On its website, the American Australian Association provides statistics that confirm that “[t]he U.S. is Australia’s largest source of foreign direct investment, with assets of \$53 billion held by American investors.”¹⁰

According to the American Australian Association, U.S. direct investment into Australia is likely to increase due to the Australia – United States Free Trade Agreement (AUSFTA). “American investment in Australia will be made easier with the FTA. Most investments will be exempted from screening by the Australian Foreign Investment Review Board with the threshold for screening in most sectors raised to \$600 million.”¹¹ Under the AUSFTA, “90 per cent of investments that were screened prior to the FTA will now be exempted from screening,” benefiting U.S. investors with an interest in Australia.¹²

Under the AUSFTA, U.S. investors will be attracted to “Australia’s growing services market, including telecommunications, express delivery, computer and IT, tourism, energy, construction and engineering, financial services, audio-visual and entertainment, professional, education and training.”¹³

In a media release dated January 1, 2005, then U.S. Trade Representative, Robert B. Zoellick, stated that the AUSFTA “is a milestone in the history of our alliance,”¹⁴ as it was the first FTA between the U.S. and a developed state since 1988.¹⁵ Zoellick continued, “[t]his is a 21st century, state-of-the-art agreement that reflects the modern globalized economy. By opening trade . . . [and] eliminating barriers in . . . investment . . . the agreement will strengthen

8. New S. Wales Dep’t of State and Reg’l Dev., Foreign Direct Investment Confidence Index 2004, available at <http://www.business.nsw.gov.au/facts> (follow “Section B-Trade and Investment” hyperlink, then follow “B6: Foreign Direct Investment Confidence Index, 2004” hyperlink).

9. New S. Wales Dep’t of State and Reg’l Dev., *supra* note 8 (follow “Section B-Trade and Investment” hyperlink, then follow “B9: Stock of Foreign Investment in Australia by Country, 2004” hyperlink).

10. American Australian Association, *supra* note 5.

11. *Id.*

12. *Id.*

13. *Id.*

14. Press Release, U.S. Mission to the U.N. in Geneva, Landmark U.S.-Australia Free Trade Agreement Goes into Effect Today, (Jan. 1, 2005), available at <http://us-mission.ch/Press2005/0103landmarkusaaustralia.htm> (last visited Nov. 28, 2006).

15. *Id.*

U.S.-Australian economic ties.”¹⁶

The effect of the recently enacted AUSFTA is likely, therefore, to increase investor interest in Australia by providing greater market access for U.S. firms.

Much of Australia's FDI activities results from cross-border M&A. According to the New South Wales Department of State and Regional Development website: “[T]he growth in M&A activity reflects the strength of Australia's corporate sector. Strong profits and healthy balance sheets are encouraging Australian companies to actively seek growth opportunities via M&A, both domestically and offshore. Overseas companies are also buying into Australian companies.”¹⁷

In light of the above, given that corporate law is a significant product having a presence in the market for corporate control “down under,” the design of this product should be of interest just as much to Americans (as well as investors in other jurisdictions) as to Australians.

It will be explained that while Australia is a significant player in the region in terms of M&A, as one of the main M&A markets in the world, the market is not large enough to warrant the elaborate regulatory system operating in Australia at present. It is simply not efficient and does not work as far as product design is concerned.

But change can be achieved without law reform. Rather than law reform, economic efficiency can be injected into Australia's takeover law by turning to the U.S. for inspiration, starting with an economic analysis of law, with the law framed as a product in a market whose existence can be justified if an efficiency improvement can be achieved. Perceiving the law as a product in a market allows us to draw upon principles of marketing, rather than adopting a conventional approach of law reform, to make the product more effective. Marketing is about responding to consumer demand. There is no reason why the product of takeovers law should be removed from this process. This will be explored in later sections.

The overriding position in this article is that as much as is appropriate (that is, in the absence of clear distortions impeding adequate investor protection and business efficacy), the market for corporate control should be allowed to operate unfettered. As a participant, government should only intervene in the market when it can contribute towards the effective functioning of the market; that is, if

16. U.S. Mission to the U.N. in Geneva, *supra* note 14.

17. New S. Wales Dep't of State and Reg'l Dev., *supra* note 8.

government is a “pusher” in the sense described by Michael Porter.¹⁸

I outline a proposal for redesign of the product of Australian takeovers law, involving a fresh look at § 611(7) of Australia’s *Corporations Act 2001* (Cth), to achieve just that.

*Towards Thinking about Australian Corporate Law: Drawing
Inspiration from the United States*

A lot has been written recently about convergence, and about the possibility of an “end of history,”¹⁹ in corporate law. I believe that “Americanizing” Australian corporate law would have significant benefits, both in terms of corporate law practice and theory.

Convergence along American lines would not simply be about eliminating a conflict between ideologies, but would also be about injecting life, energy and innovation into the practice and scholarship of corporate law. As this article will demonstrate in the specific context of takeovers law, this is a positive move.

Turning to the U.S. to generate inspiration for Australian corporate law would prove very beneficial. In particular, a lot can be gained through applying an economic analysis of law and corporate law, which was born out of the U.S.

As will be explained further in later sections, economic analysis treats the corporation as a collection of contracts between stakeholders, and corporate law as a set of default terms which companies can (or ought to be able to) opt in or out of based on a cost-benefit analysis of the utility of these terms. External regulation in the form of corporate law rules is considered justifiable only if the rules can generate an efficiency improvement over and above the market. In the specific area of takeovers regulation, economic analysis sees corporate law rules operating in a “market for corporate control.”

Corporate law rules can therefore collectively be treated as a product in a market, and will only (and should only) survive if they are designed and marketed effectively to respond to consumer demand in the market.

Structure of the Article

One key theme of the article, which will shape the analysis and my approach, is that corporate law, and regulation through public sources

18. MICHAEL E. PORTER, *THE COMPETITIVE ADVANTAGE OF NATIONS* 681 (1998).

19. See Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001).

more generally, is a product in the market for corporate control. To have in place an effective place in the market, the product provider needs to work out how to best deliver it so that it performs a desirable function. In this sense, this article is very much about the effective marketing of Australian takeovers law, and the application of established principles of marketing to achieve better product management, rather than being about conventional law reform.

We are dealing with a market for corporate control, a strong market with a lot of potential, and therefore need to approach Australian takeovers law through this fresh lens.

Accordingly, Part I explores in some detail basic principles of marketing, and the specific arm of marketing known as product management, and applies this learning to takeovers law in order to explore how this product can be made more effective in a market for corporate control.

Takeovers law is placed in an otherwise unfettered market for corporate control and needs to be approached as such. We are simply dealing with a product in a market, and working out how to design and manage that product so that its place in the market is justified.

This article also takes the position that regulatory reform is only warranted if it leads to an efficiency improvement. It is explained that this does not come at the expense of investor protection. The vision for takeovers regulation explored in this article does not in any way undermine investor protection. The protections that have been in place will remain in place. Moreover, it could be said that investors are in fact greatly empowered by the vision outlined by way of enhanced choice.

It is time for excitement, innovation, and just plain thinking, about Australian corporate law, and takeovers law more specifically. As will be elucidated, innovation leads to improved efficiency, and the injection of efficiency leads to tangible improvements in the economy which helps people's lives. In this case, a more sophisticated market for corporate control, can produce a stronger economy.

As former Australian Prime Minister Paul Keating said in 1996, "[i]n the end it's the big picture which changes nations," and "[t]here has to be imagination, and there's got to be belief."²⁰

This article is structured as follows. Part I provides some

20. Prime Minister Paul Keating (Austl.), Concession Speech (Mar. 2, 1996), available at <http://www.australianpolitics.com/elections/1996/96-03-02keating-concession.shtml> (last visited Nov. 28, 2006).

background on the U.S. economy and the U.S. takeovers market, as a prelude to exploring the economic analysis of law- a movement which began in the U.S. There will be a particular focus on the economic analysis of takeovers regulation, along with a discussion of takeovers regulation in the U.S. The concept of the "market for corporate control" will be considered.

Part II introduces the reader to Australian takeovers regulation. Through two key regimes making up the regulation of takeovers, or what will also be referred to as "corporate control transactions," the "Chapter 6" takeovers code and the scheme of arrangement procedure in Part 5.1 of the *Corporations Act*, will also be explored. Section 611(7) of the *Corporations Act*, an important component of the regulation of takeovers in Australia and which is central to the discussion in Part III, will also be introduced.

In Part III, I paint a picture of how I would like takeovers law in Australia to be approached. First, it is argued that, drawing on U.S. economic analysis of law, corporations should have greater freedom concerning whether they abide by formal takeover rules (takeovers law provided in legislation), or provide their own alternative rules. It is discussed that this potential for flexibility is already facilitated in Australian takeovers regulation, but is not really treated as such.

If this flexibility is embraced, it is argued that there would not be the need for a dual regime of Chapter 6 and schemes to regulate takeovers in Australia. Accordingly, contrary to what Australian M&A lawyers Tony Damian and Andrew Rich contend in their recent monograph *Schemes, Takeovers and Himalayan Peaks*,²¹ I believe that the schemes regime should no longer be used for takeovers. It is in this sense that I argue it is time to return down the mountain. I argue that takeovers law in Australia should come in the form of a self-contained Chapter 6. It is explained that, with greater use of § 611(7) of the *Corporations Act*, this would not come at the expense of some acknowledged commercial benefits of using schemes of arrangement for corporate control transactions as an alternative to Chapter 6.

Part III also explains how § 611(7) of the *Corporations Act* can be utilized to provide for greater flexibility in the regulation of takeovers, and make Australian takeovers law more efficient and effective as a product in the market for corporate control. Part IV concludes.

21. TONY DAMIAN & ANDREW RICH, *SCHEMES, TAKEOVERS AND HIMALAYAN PEAKS* (2004).

I. ALL THE WAY WITH THE U.S.A.

A. *Harold Holt was Right*

This article draws inspiration from the U.S. to improve the design of Australian takeovers law in the market for corporate control. It is in this sense that I believe we should go “all the way with the U.S.A.”

This is similar to the statement made by former Australian Prime Minister, Harold Holt, in 1966 that Australia should go “[a]ll the way with LBJ”²² – referring to U.S. President Lyndon Johnson. Holt made the statement as support for the U.S.-led Vietnam War.²³

Below I provide some context for why I believe that Australia should follow the U.S. line in regulating takeovers.

B. *The Brilliance of the U.S. Economy*

According to the World Bank’s World Data Profile for 2004, the world GDP for 2004 was \$41.4 trillion (USD) (40.3 trillion GNI). During this period, U.S. GDP was \$11.7 trillion (USD) (12.1 trillion GNI). Therefore, the U.S. accounts for roughly 25% of the world economy.²⁴

The magnitude of the U.S. economy is emphasized by considering the size of other developed economies. According to the same World Bank data, for 2004, UK GDP was \$2.1 trillion (USD), Japan was \$4.6 trillion (USD), Germany was \$2.7 trillion (USD), China was \$1.9 trillion (USD), Canada was \$978 billion (USD), and Australia was \$637 billion (USD).²⁵

C. *The Brilliance of the U.S. Takeovers Market*

The U.S. takeovers market is second to none in terms of size and sophistication. According to Mergermarket.com’s “Deal Drivers USA-Half Year 2005,”²⁶ in the first half of 2005, “buyers bought North American targets with a combined value about 30% higher than the first

22. Australia’s Prime Ministers, Harold Holt, <http://primeministers.naa.gov/au/meetpm.asp?pageName=inoffice&pmId=17> (last visited Dec. 7, 2006).

23. See also TOM FRAME, *THE LIFE AND DEATH OF HAROLD HOLT* (2005).

24. The World Bank Group, World Development Indicators Data Query, <http://devdata.worldbank.org/data-query/> (last visited Nov. 23, 2006).

25. *Id.*

26. Mergermarket.com, Deal Drivers USA – Half Year 2005, August 1, 2005, http://www.mergermarket.com/public/default.asp?pagename=remark_detail&docid=723 (last visited Nov. 23, 2006).

half of last year. At \$531[billion], it is on pace to hit \$1 [trillion].”²⁷

Mergermarket.com explains that “North American mergers have not passed that milestone since 2000 when they totaled close to \$1.7[trillion] . . . [T]here were three \$20 [billion] plus deals in the first half of 2005 . . . There were eight deals with values between \$10 [billion] and \$20 [billion].”²⁸

According to recent worldwide M&A data from Thomson Financial, for the third quarter of 2004 “worldwide M&A activity checked in at \$391.5 billion . . . bringing the cumulative 2004 dollar value to \$1.27 trillion.” For the U.S., M&A in the first three quarters of 2004 totaled \$568 billion. The third quarter total was \$154.4 billion.²⁹ Importantly, what this means is that U.S. M&A account for roughly 40% of worldwide M&A.

In a recent article published in the *Columbia Journal of European Law*, Mathias Siems commented that the U.S. M&A market is only going to get bigger, due to a growth in cross-border mergers – in which the U.S. will be one party to the merger.³⁰

D. *The Brilliance of U.S. Legal Scholarship*

There is much that the U.S. can be proud of when it comes to legal scholarship. It is clearly home to the best law schools and faculty in the world.

One particular initiative that has stemmed from the work of U.S. scholars, and has had a profound impact on the way we think about the law (including corporate law and takeovers regulation) is the economic analysis of law – otherwise known as “law and economics.”

1. *What Do We Mean by Economic?*

Before delving into an exploration of the economic analysis of law, it is important that one is clear regarding what “economic” means in this context. According to the doyen of the modern law and economics movement, Richard Posner, economics must “explore the implications of assuming that man is a rational maximiz[er] of his ends in life, his

27. *Id.*

28. *Id.*

29. THOMSON FINANCIAL, THOMSON FINANCIAL WORLDWIDE M&A (2004), available at http://www.thomson.com/pdf/financial/league_table/ma/3Q2004/24411/3Q04_MA_PR_US_Global.pdf (last visited Nov. 23, 2006).

30. See generally Mathias M. Siems, *The European Directive on Cross-Border Mergers: An International Model?*, 11 COLUM. J. EUR. L. 167 (2004).

satisfaction," defined as "self-interest."³¹ This concept of man implies man's response to incentives; "that if a person's surroundings change in such a way that he could increase his satisfactions by altering his behavior, he will do so."³²

David Barnes and Lynn Stout have also provided a useful explanation of the meaning of "economic."³³ In their treatise on law and economics, they define economics as concerning the resolution of competing claims. Notwithstanding the various political perspectives from which economists evaluate law, "many take the traditional or neo-classical perspective that evaluates the benefits and burdens of a legal rule according to a single principle, economic efficiency."³⁴

Economic studies rational choice in a world of scarcity. The fundamental goal of economic analysis is getting the most from the scarce resources available to satisfy society's needs and wants by allocating them efficiently among competing uses.³⁵

2. *Efficiency in Economics*

As we can see from the above commentary, a central concept operating in the field of economics is that of "efficiency." According to Posner in *The Economic Analysis of Law*, "efficiency" means the "allocation of resources in which value is maximized."³⁶ Economic analysis perceives efficiency as being about "directing resources to their most valuable use."³⁷

Hans-Bernard Schaffer and Claus Ott in their work *The Economic Analysis of Civil Law* provide another explanation of efficiency, as employed by economists, which "has nothing to do with its common usage."³⁸ A society has achieved efficiency where its members and its resources "have achieved the highest possible level of utility."³⁹

31. RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 3-4 (5th ed. 1998).

32. *Id.* at 4.

33. See DAVID W. BARNES & LYNN A. STOUT, *CASES AND MATERIALS ON LAW AND ECONOMICS* (1992).

34. *Id.* at 1. As to the meaning of "efficiency" in this context, Barnes and Stout state that: "Allocative efficiency means using scarce resources to the greatest possible advantage, 'getting the most' out of them. Whether a particular use is efficient will depend, by definition, on what exactly one wants to gain or accomplish." *Id.* at 6.

35. *Id.* at 1-2.

36. POSNER, *supra* note 31, at 13.

37. BARNES & STOUT, *supra* note 33, at 17.

38. HANS-BERNARD SCHAFER & CLAUS OTT, *ECONOMIC ANALYSIS OF CIVIL LAW* (2004).

39. *Id.* at 8.

The meaning of efficiency as used by economists has nothing to do with its common

This explanation of efficiency refers to a particular type of efficiency known to economists as "Pareto efficiency." This is different from "Kaldor-Hicks Efficiency," which is well known in welfare economics.⁴⁰

3. *Economic Analysis of Law in General*

Scholarship in corporate law, as well as most other areas of the law, has been made far more dynamic and interesting through the application of thinking and concepts arising out of the economic analysis of law in the U.S.

Even though a certain amount of the assumptions and conclusions derived from an economic analysis of law are questionable, there is no question that it has made people think, and has changed both the scholarship, and even the practice of a variety of areas of law, for the better.

Economic analysis of the law underpins the ideas contained in this article. The "economic theory of law", according to Posner, uses economics to "explain as many legal phenomena as possible."⁴¹ Legal regulation employs cost-benefit analyses to allocate resources in an efficient manner.⁴² "Much of [the economic analysis of law] is concerned with proposing economic explanations for legal phenomena modeled in economic terms."⁴³

According to Yale's Jules Coleman, Posner believes that where

usage. It has a very precise meaning that can then be used as an elementary principle for the design of social institutions. A society is considered efficient, if and only if, under the given endowment it is no longer possible to improve the welfare of any individual and at the same time no individual has been made worse off. In other words, given the resources initially available and their allocation, the members of a society have achieved the highest possible level of utility. It should be clear that a society with efficient institutions and legal systems is not necessarily just. It may be the case that one has to accept a loss of efficiency in order to achieve particular normative goals.

See also RAY STEINWALL ET. AL., BUTTERWORTHS AUSTRALIAN COMPETITION LAW 97-98 (2000) ("Economic efficiency . . . refers to a situation where the economic system allocates resources in such a way as to produce the goods and services which consumers value most highly and are prepared to pay for, and it does so at the least possible price in terms of resource use.").

40. For a discussion of these concepts, see Jules L. Coleman, *Economics and the Law: a Critical Review of the Foundations of the Economic Approach to Law*, 94 ETHICS 649, 650-52 (1984).

41. POSNER, *supra* note 31, at 28.

42. *Id.* at 27-28.

43. *Id.* at 18. See also Richard Posner, *The Economic Approach to Law*, 53 TEX. L. REV. 757 (1975); Avery Wiener Katz, *Positivism and the Separation of Law and Economics*, 94 MICH. L. REV. 2229 (1996).

there are transaction costs giving rise to a role for the law, the law ought to “mimic the market.” That means that “the law ought to mimic . . . the Coasian market of rational, fully informed individuals completely cooperating with one another in an effort to maximize joint welfare (or profits) through mutually beneficial exchange.”⁴⁴

Coleman also usefully explains that Posner’s economic analysis of law suggests that, “what is efficient depends on what people are willing to pay and what people are willing to pay in turn depends on what they are capable of paying.”⁴⁵

4. *Economic Analysis of Corporate Law*

The economic analysis of law has been usefully applied to numerous specialized areas of law. One of the more successful efforts of utilizing economic analysis has been in the area of corporate law, being the rules that regulate corporations (thus including takeovers regulation).⁴⁶

In a recent article, UCLA law professor Stephen Bainbridge has provided an excellent summary of how the corporation (and corporate law rules) are understood applying an economic analysis of law. Bainbridge, in the law and economics literature (with the so-called “nexus of contracts” understanding of the corporation), suggests how to obtain corporate law default rules: “If the parties could costlessly bargain over the question, which rule would they adopt?”—and then adopt that bargain as the corporate law default rule.”⁴⁷

44. See Coleman, *supra* note 40, at 659.

45. *Id.* at 662.

46. See Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 57 (2002):

The governance of U.S. corporations is largely determined by the law of the state in which each firm has chosen to incorporate. . . . Governance provisions in stock exchange listing agreements can also be considered a form of contract given firms’ ability to choose the exchange or exchanges on which they are listed.

Id.

47. Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1744 (2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=808584.

[L]egal rules are analogized to a standard form contract voluntarily adopted – perhaps with modifications – by the parties. As with any standard form contract, the law’s principal purpose in this area is to facilitate private ordering by reducing bargaining costs. Parties for whom the default rule makes sense thus can take the default rules off the rack, without having to bargain over them. Parties for whom the default rules are inappropriate, however, remain free to bargain for a different rule. . . . In such settings, identifying the party for whom getting its way has the highest value becomes the crucial question. If termination costs are zero, the default rules- whether contained in a statute or private standard form contract- do not matter

In this sense, corporate law rules are a product that parties (corporations) can choose to purchase “off the rack,” or choose an alternative product.⁴⁸

This “contractual” approach is beginning to have a major influence on European corporate law and scholarship. This is the result of the phasing out of the “real seat doctrine,” and the shift to a “state of incorporation” doctrine, through a series of decisions of the European Court of Justice, starting with *Centros*.⁴⁹ The European Court of Justice found that the real seat rule (which was applied in most EU member states) was incompatible with the Freedom of Establishment guaranteed by the Maastricht Treaty establishing the European Community.

According to Dammann, with the adoption of a state of incorporation doctrine, “it is the law of the state of incorporation, rather than the law of the state in which the corporation’s headquarters is located, that governs the corporation’s internal affairs.”⁵⁰ Dammann goes on to explain that under the real state doctrine, corporations could not choose the law of another EU Member State unless they were willing to move headquarters. Thus, “because the costs of such a move usually outweighed the advantages connected with a more efficient corporate law, the real seat doctrine effectively prevented free choice.”⁵¹

very much. In the face of positive transaction costs, however, the default rules begin to matter very much. Indeed, if transaction costs are very high, bargaining around the rule may become effectively impossible. In such settings, identifying the party for whom getting its way has the highest value becomes the crucial question. . . . We therefore perform a thought experiment: “If the parties could costlessly bargain over the question, which rule would they adopt?”, and then adopt that bargain as the corporate law default rule.

Id.

48. For discussion of the law as a product, see Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON & ORG 225-53 (1985); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L. J. 2359 (1997-98); see also Oren Bar-Gill, Michael Barzuza & Lucian Bebchuk, *The Market for Corporate Law* (Harvard John M. Olin Center for Law, Econ., and Bus., Discussion Paper No. 377, July 2002); Ronald J. Gilson & Reiner H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984).

49. See, e.g., Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 2 J. CORP. LAW STUDIES_(2005); see also Robert Drury, *A European Look at the American Experience of the Delaware Syndrome*, 5 J. CORP. LAW STUDIES_(2005); John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, (Eur. Corp. Governance Inst., Working Paper No. 54/2005, 2005); Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 56 (2005). “Three decisions by the European Court of Justice - *Centros*, *Überseering* and *Inspire Art* . . . is incompatible with the Freedom of Establishment guaranteed by the Treaty Establishing the European Community (TEC).” *Id.*

50. Dammann, *supra* note 49, at 53.

51. *Id.* at 55. See also Jens C. Dammann, *Freedom of Choice in European Corporate*

5. *Economic Analysis of Takeovers and the "Market for Corporate Control"*

Economic analysis of corporate law has become an incredibly specialized branch of law and economics over the last few decades. Over this time, there has been a major focus on applying the tools of economics to a particular branch of corporate law- the rules regulating takeover-style corporate control transactions.

This application of economic analysis was kicked off largely by a paper published in 1965 by law professor Henry Manne.⁵² In this paper, Manne introduced the concept of a "market for corporate control" which could discipline directors and managers, and work to align their interests with the interests of shareholders.⁵³

Until this time, corporate control transactions were examined solely in terms of antitrust (competition) implications, rather than their impact on the internal governance arrangements of a corporation. *Ford's Principles of Corporations Law* provides a useful account of the thinking behind the market for corporate control, identifying reasons for and against regulation where company management succeeds or fails in achieving efficiency.⁵⁴

Law, 29 YALE J. INT'L L. 477, 479-82 (2004); Carsten Frost, *Transfer of Company's Seat – An Unfolding Story in Europe*, 36 VICT. U. WELLINGTON L. REV. 359, 364-69, 374 (2005) ("One crucial consequence of the . . . ECJ judgments is that founders within the EU are now free to choose the company law they prefer."); Andrea J. Gildea, *Uberseeing: A European Company Passport*, 30 BROOK. J. INT'L L. 257 (2004).

52. See Henry Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECO. 110 (1965); William J. Carney, *The Legacy of the "Market for Corporate Control" and the Origins of the Theory of the Firm*, 50 CASE W. RES. L. REV. 215 (1999) (describing the origins of the market for corporate control, and Henry Manne's contribution to the law and to economics); Kenneth Lehn, *The Market for Corporate Control: Some Observations on Henry Manne's Contribution to Financial Economics*, 50 CASE W. RES. L. REV. 263 (1999).

53. *Id.* at 112, 113. He famously stated that, "[t]he lower the stock price, relative to what it could be with more efficient management, the more attractive the take-over becomes to those who believe that they can manage the company more efficiently." *Id.* See George Bittlingmayer, *The Market for Corporate Control*, in ENCYCLOPEDIA L. & ECON., 725, 730 (1999) ("Though control transactions have a long history in fact and in law, the academic literature on the 'market for corporate control' and indeed the term itself begin with Henry Manne (1965). His analysis focused on control transactions that would address the problem of poor management . . . Manne also argued that control of the corporation was a valuable asset, and he advanced the idea of a 'positive correlation between corporate managerial efficiency and the market price of shares.'").

54. R P AUSTIN & I. M. RAMSAY, *FORD'S PRINCIPLES OF CORPORATIONS LAW* sec. 23.060 (12th ed. 2005).

Some commentators maintain that there is a market for corporate control which provides an effective mechanism for correcting bad management. If a company is badly managed, its shares will not reflect the company's true value. If the market for corporate control is efficient, control will pass to an entrepreneur who is

According to *Ford's*, due to this potential market for corporate control, "[t]he imposition of any additional layer of regulation is controversial."⁵⁵

In a now classic paper on corporate control transactions, Easterbrook and Fischel also explore how an unregulated market for corporate control will reduce agency costs to shareholders and, thus, increase the value of assets.⁵⁶

Another useful commentary on the function of the market for corporate control was provided recently by Stephen Bainbridge in the *Delaware Journal of Corporate Law*. The market for corporate control, according to Bainbridge, "is the ultimate monitor that makes the modern business corporation feasible" to the extent that potential unsolicited bidders have the incentive to investigate managerial inefficiencies resulting in a depressed stock price.⁵⁷

prepared to replace the inefficient managers and thereby create an environment in which shares will be fully valued. Regulation necessarily interferes with the efficient operation of the market for corporate control, and on this view regulation is consequently undesirable. . . . Others argue that in the absence of regulation, shareholders of the target company are likely to be disadvantaged by a change of control. Small shareholders are particularly at risk, because control of the target may pass when the offeror purchases the holdings of a small number of large shareholders at premium prices, and small shareholders may have no opportunity to sell. . . . An intermediate position is to contend that takeover law should be optional to the limited extent that shareholders should be entitled to decide whether their company should be subject to particular mandatory rules.

Id.

55. *Id.* Troy Paredes also had commented on the regulatory implications of an active market for corporate control that:

Corporate law is an important part of corporate governance, but so are markets. It has long been argued that an active market for corporate control disciplines directors and officers to run the business profitably. . . . [Further, a] robust takeover market should hold directors and officers more accountable for their actions and, hopefully, curb any future outbreaks of greed, disloyalty, and mismanagement on the scale of recent abuses.

Troy Paredes, *The Firm and the Nature of Control: Towards a Theory of Takeover Law*, 29 IOWA J. CORP. L. 103, 177-78 (2003).

56. Frank H. Easterbrook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 701 (1982) ("[T]he threat of sales of corporate control induces managers to perform well in order to keep their positions.").

Corporate control transactions can reduce agency costs if better managers obtain control of the firm's assets or if they alter the incentive structure facing existing managers. Corporate takeovers, and subsequent changes in management, increase the wealth of investors. . . . [F]ree transferability of corporate control, like any other type of voluntary exchange, moves assets to higher valued uses.

Id. at 705.

57. Stephen Bainbridge, *Unocal at 20: Direct Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. (forthcoming 2006) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=796224#PaperDownload

[B]ecause keeping the stock price up is the best defense managers have against

It is also useful to consider the impact of the recognition of a market for corporate control in terms of corporate governance in general. In an article published in 2003, David Westbrook did exactly that, explaining how, in the takeover market, the interests of profit-seeking shareholders diverge from those of inefficient managers.⁵⁸

This thinking on the market for corporate control, and the economic analysis of corporate law and takeovers regulation, will be applied in subsequent sections to promote a more marketable and effective regime for regulating takeovers in Australia. It will be explained that there is the potential to approach Chapter 6 of the *Corporations Act*, and § 611(7) in particular, will give greater recognition to the market for corporate control and instill more flexibility in the market.

E. The Brilliance of U.S. Takeovers Regulation

In relation to U.S. takeovers regulation, there is an emphasis on building a culture of disclosure, complemented by corporate law rules, rather than treating takeovers as a hotbed for regulation. U.S. takeovers law is based on a similar governing objective as Australian corporate law (in particular that there be an efficient, competitive and informed market for corporate control), but with less in the way of black-letter law – particularly at the federal level. This is despite the U.S. having an

being disciplined by an outside searcher, the market for corporate control – more specifically, the unsolicited tender offer – is an important mechanism for preventing shirking by top management. Indeed, some would argue, the market for corporate control is the ultimate monitor that makes the modern business corporation feasible. . . . If close examination by a prospective bidder reveals that the declining market price is in fact attributable to shirking by the top management team, however, a disciplinary takeover could produce real gains for division between the targets shareholders and the successful acquirer. This prospect creates positive incentives for potential bidders to investigate when the market signals a firm is in distress.

Id.

58. David A. Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Re-imagination*, 92 GEO. L.J. 61, 102 (2003).

If Berle and Means inaugurated an era of corporate doctrine focused on the separation of ownership and management and management's ability to abuse shareholder interests, then Henry Manne may be said to have inaugurated the next orthodoxy. At least since Manne's work in the 1960s, corporate governance has been understood as a commodity, regulated, like other commodities, by market mechanisms. In particular, Manne and his many epigones taught that managers were not free to do as they pleased with shareholders' money but were constrained by market forces. There was a market for corporate control – it is, a takeover market – wayward managers could and would be ousted by profit-seeking shareholders.

Id.

economy, and a M&A market, many times the size of Australia's.

According to Mannolini, the U.S. "predominantly employ rigorous mandatory disclosure and procedural requirements as restraints upon the agency problems inherent in the corporate contract."⁵⁹

As to the successful operation of a system of disclosure in the U.S., Cassidy and Chapple have usefully commented on the distinctions between the U.S. disclosure regime and that of Australia. They suggest that the more strict U.S. laws facilitate self-regulation and expedited disclosure, particularly when companies present bad news for shareholders.⁶⁰

Before proceeding to detail the rules regulating corporate control transactions, an overview is useful. In his excellent casebook on companies and securities law, Paul Redmond summarizes the U.S. disclosure-based regime.⁶¹

In the U.S., federal law is essentially disclosure based while much state law is primarily concerned with protection of non-shareholder interests including management, employees and local community interests in takeovers; that is not the case with Delaware where many corporations are incorporated. In the U.S., there is a relatively greater freedom for both bidder and target management, and auctions for corporate control tend to be easier and more common. There is no direct counterpart to the equality of opportunity principle. The contest between bidder and target sometimes becomes a Hobbesian struggle, showing nature red in tooth and claw.⁶²

59. Mannolini, *supra* note 7, at 358. See Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047 (1995).

60. Andrew Cassidy & Larelle Chapple, *Australia's Corporate Disclosure Regime: Lessons from the U.S. Model*, 15 AUSTL. J. CORP. L. 81, 85 (2003).

The enforcement of disclosure rules is a significant difference between the disclosure regimes in the United States and Australia. In Australia criminal and civil actions (including civil penalties) for disclosure breaches are rare, which has resulted in less pressure on companies to provide timely and accurate information. In contrast, U.S. companies have a stronger incentive to disclose because they operate in a disclosure regime of strict enforcement, at least due to SEC enforcement mechanisms being supplanted by private enforcement of disclosure law The literature examining the US securities market suggests that strong enforcement of disclosure law encourages companies to increase the quality and timeliness of information presented to the market. Companies will preempt the announcement of bad news to avoid large stock price decline, and subsequent lawsuits on earnings announcement.

Id.

61. See PAUL REDMOND, *COMPANIES AND SECURITIES LAW: COMMENTARY AND MATERIALS* 890 (4th ed., N.S.W.: Lawbook Co. 2001) (1998).

62. *Id.*

As will be explained later, given the success of American takeovers law, there is little doubt that an international convergence in corporate law will lead to the Americanization of takeovers regulation. Australia's corporate law already has the infrastructure to embrace this convergence, without the need for radical and costly surgery in the form of law reform, ensuring that it remains a market leader in our region.⁶³

Commentators such as Thomson and Mannolini contend that through convergence towards an Anglo-American model of corporate regulation, the dominant paradigm internationally will be economic efficiency.⁶⁴ Economic efficiency comes from product design and management so that customers entering the market are willing to transact. The prerequisite for an effective contract, as you may recall, is willingness to enter into legal relations. The concepts of product design and management, and their applicability to takeovers law, will be discussed in the next section.

There has recently been a move in Europe to converge towards what can be considered an Anglo-American approach to takeovers regulation.⁶⁵

Under the 13th Company Law Directive on Takeovers, which EU member states must now move to implement, contractual freedom through "opt in" and "opt out" arrangements will become an important feature of European takeovers law. Member states will be able to opt out of some of the more contentious aspects of the Takeovers Directive in their own domestic takeovers law. According to European law firm Eversheds, "[t]he compromise now incorporated in the Directive allows Member States to opt out of either or both of the prohibition on frustrating action and the 'break-through' provision, although any Member State that does so must permit individual companies to opt in again."⁶⁶

63. See Hansmann & Kraakman, *supra* note 19 (talking about the competitive success of British and American corporations). There is talk of convergence in other contexts as well. Most famously, in his book, *THE END OF HISTORY AND THE LAST MAN* (1992), Francis Fukuyama wrote that the only challenge before the world now is to forge a rational global order that accommodates humanity's restless desire for recognition with a return to chaos. FRANCIS FUKUYAMA, *THE END OF HISTORY AND THE LAST MAN* (1992). "History" is defined in the book to mean "clash of political ideologies." *Id.*

64. See Mannolini, *supra* note 7, at 359; Robert B. Thompson, *Takeover Regulation after the 'Convergence' of Corporate Law*, 24 SYDNEY L. REV. 323, 327 (2002).

65. See Andrea Guaccero, *Recent Developments in European Takeover and Corporate Law*, 12 CARDOZO J. INT'L & COMP. L. 91, 92-93 (2004).

66. Eversheds, *The European Takeover Directive* (Jan. 17, 2005), http://www.eversheds.com/uk/Home/News_room/Publications.page (select "Corporate" hyperlink; then follow article, title and publication date hyperlink).

The opt out component of the Takeovers Directive was introduced principally because of German objections to the proposed prohibition on frustrating action.

Another strong sign that the European Takeovers Directive was heavily influenced by the regulation of corporate law in the U.S., and the U.S. economic analysis of law is paragraph 6 of the Preamble to the European Takeovers Directive, which very neatly sums up the vision underlying this article as to how takeovers regulation can be repackaged and more effectively marketed: "In order to be effective, takeover regulation should be flexible and capable of dealing with new circumstances as they arise and should accordingly provide for the possibility of exceptions and derogations. However, in applying any rules or exceptions laid down or in granting any derogations, supervisory authorities should respect certain general principles."⁶⁷

F. Explanation of U.S. Federal and State Takeovers Law

What follows is a discussion of the mechanics of federal and state takeovers law. I have selected some of the best explanations of the law from recent journal articles, and provided extracts of these below. The focus in this article is on federal law, although adequate attention will be given to state law, particularly the law in Delaware where the majority of public corporations in the U.S. are incorporated.

1. Federal Law- Tender Offers

What I consider to be the best explanation of how tender offers, a device regulated by federal law, work was provided by Kwang-Rok Kim in an article published in the *Pacific Rim Law & Policy Journal*.⁶⁸ According to Kim, changes in laws governing tender offers have promoted competition in the tender market by facilitating information flow and enlarging the duration of the process.⁶⁹

67. Council Directive 2004/25, pmbl., para. 6, 2004 O.J. (L 142) (EC) available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:NOT> [hereinafter 13th Company Law Directive on Takeover Bids]. See also Aditi Bagchi, *The Political Economy of Merger Regulation*, 53 AM. J. COMP. L. 1 (2005).

68. Kwang-Rok Kim, *The Tender Offer in Korea: An Analytic Comparison between Korea and the United States*, 10 PAC. RIM L. & POL'Y J. 497 (2001).

69. *Id.* at 499, 504-07, 508-11. According to Kim:

Tender offers represent the most significant tactical development in the United States' corporate takeover arena, and have been the "hottest" subject in the legal world of corporations and securities for three decades. Prior to the passage of the Williams Act, bidders could make very short tender offers, lasting only several days.

The Williams Act was passed in 1968, and exists today to ensure that shareholders

Kim goes on to discuss the mechanics of the federal tender offer:

During the 1960s, tender offers, appeared in the United States, and now are widely regarded as "the most effective means . . . for wresting control from a resisting management," as increasing numbers of investors have embarked on campaigns to acquire controlling stock interests in publicly-held corporations. In 1968, Congress passed the Williams Act as an amendment to the Securities Exchange Act of 1934 ("Exchange Act").

The Williams Act added the following provisions to the Exchange Act. Section 13(d) of the Exchange Act is designed to provide shareholders with knowledge of potential purchasers' identities and intentions by requiring disclosure from all owners of greater than 5% of any class of securities. Section 13(e) limits an issuer in purchases of its own securities. The SEC occasionally uses Section 13(e) to "regulate self-tender offers, issuer repurchases in the open market, and going-private transactions." Section 14(d), the major provision affecting tender offers, requires any person who plans to make a

of target companies have the information and time necessary to consider offers, that shareholders are treated equitably, and that a competitive balance is maintained between tender offerors and target companies.

Id. at 499. See also Hui Huang, *China's Takeover Law: a Comparative Analysis and Proposals for Reform*, 30 DEL. J. CORP. L. 145, 166-67 (2005).

A cash tender offeror could operate in virtual secrecy like a corporate raider in the pre-Williams Act era because the law did not require that "[a cash tender offeror] disclose his identity, the source of his funds, who his associate were, or what he intended to do if he gained control of the corporation." The Williams Act was designed to protect investors by requiring sufficient information to be provided to enable them to make an informed decision with respect to a tender offer. It is the purpose of the Williams Act that the target company management adopt appropriate defensive tactics to increase the value to target shareholders.

The objective of shareholder protection, however, may conflict with the economic objectives of efficiency in resource allocation to the extent that the rule would render the hostile takeover more difficult and thus diminish the contestability of takeovers. The substantial costs associated with information disclosure and tender offer rules, which are designed to protect investors, may effectively deter many takeovers that otherwise would have been launched. Furthermore, it is widely recognized that the target's management has the incentive to abuse defensive tactics with respect to hostile takeovers for the purpose of entrenchment. Some takeover defenses, which were originally designed as a means to protect target shareholders from raiders, have been found to be frequently misused by the target's management. For example, the target's management would use defensive measures to thwart a hostile takeover that would injure their interests, regardless of whether the takeover would be beneficial to the shareholders, resulting in the diminished contestability of takeovers. This problem has been at the heart of the discussion of takeover law and received a wide range of practical and academic attention.

Id.

tender offer to submit all materials used in connection with the tender offer to the SEC and to submit a disclosure statement similar to the one required by 13(d). Section 14(e) prohibits fraud and "material" misrepresentation in connection with a tender offer. Specifically, 14(e) makes unlawful any untrue statement of material fact, any omission tending to make statements misleading, and any fraudulent, deceptive, or manipulative acts in connection with any tender offer. Section 14(e) also gives the SEC authority to define and prescribe means reasonably designed to prevent such acts.⁷⁰

More detail is also provided by Kim about the federal rules, including Securities & Exchange Commission (SEC) regulations, regulating tender offers.⁷¹ A useful overview of the considerations and

70. Kim, *supra* note 68, at 504-05. Kim continues:

Although tender offers have proven to be a highly effective method of taking over corporations, neither the Exchange Act nor the primary SEC Rule applying to tender offers defines the meaning of the term "tender offer." However, a conventional tender offer in the United States, as defined by extensive case law, is a public offer or solicitation by a company, an individual or a group of persons to purchase during a fixed period of time all or a portion of a class or classes of securities of a publicly-held corporation at a specified price or upon specified terms for cash and/or securities.

The United States Supreme Court, in *Blue Chip Stamps. V. Manor Drug Stores*, stated that the analysis of the term "tender offer" should begin with the language of the Williams Act. However, the Williams Act lacks a definition provision. Under Section 3(b) of the Exchange Act, the SEC has the authority to define the term "tender offer." Various SEC proposals have suggested that Section 14(d) of the Exchange Act should apply in more specific circumstances. However, none of these proposals have been successful. Thus, it is necessary to examine the SEC's attempt to define the meaning of "tender offer," and therefore the applicability of Section 14(d) disclosure requirements, through case law.

Id. at 505-06, 508.

71. *Id.* 526-27.

In the United States, the Williams Act provides the basic framework for assessing disclosure obligations in the tender offer context. Section 14(d)(1) requires the tender offeror to prepare and file a Schedule 14D-1 before commencing a tender offer for more than 5% of a target company's stock. The disclosure required in Schedule 14D-1 begins with the disclosure required by Schedule 13D.

1) SEC schedule 13D

Under Section 13(d)(1) of the Exchange Act, any person who directly or indirectly acquires more than 5% of any class of the securities registered pursuant to Section 12 of the Exchange Act must file a Schedule 13D statement with the SEC. Moreover, the investor must send a copy of the 13D statement to the issuer of the securities in question and to each exchange where the securities were traded. The information that must be disclosed on the 13D includes facts about the security and the issuer, the identity and background of the purchaser, the source and the amount of the funds or other consideration used in the acquisition, the purpose of the transaction, the interest in the securities of the issuer, the contracts, arrangements,

procedures that arise in practice in relation to federal tender offers has been provided by Christopher A. Iacono.⁷²

understandings or relationships with respect to the securities of the issuer, and the materials to be filed as the exhibits. Although Section 13(d) does not expressly require disclosure of any intent to acquire control, disclosure of the "purpose of the transaction" has been augmented by SEC regulations to require disclosure of further information regarding the purchaser's future plans for the issuer.

A loophole in Section 13(d) known as the ten-day window currently allows some abuse of the regulations by securities purchasers. During the ten-day period after a person crosses the 5% threshold of Section 13(d), thereby incurring disclosure obligations, the tender offeror may purchase securities up to an additional 20% of the class of the equity securities. By using this method, he might be able to pay less for that 25% stake than he would have to pay after his Schedule 13D disclosure. Consequently, the SEC would like to eliminate the "ten-day window" by requiring the tender offeror to file the day after buying his first 5% and prohibiting the tender offeror from buying any more shares until the filing has been completed. However, Congress has not acted on the SEC's request.

2) SEC schedule 14D-1

After nearly ten years of the federal tender offer regulation under the Williams Act, the SEC adopted a permanent tender offer disclosure schedule. SEC schedule 14D-1 mandates disclosure of substantially more information by the tender offeror than Schedule 13D.

In addition to the information required by Schedule 13D, 14D-1 requires disclosure of other specific items relating to the persons retained, employed, or to be compensated by the target company and the purchaser's financial statement and relationship with the target company. Further, as of a 1977 SEC Release, most tender offerors believe it is necessary to include their own financial statements in their Schedule 14D-1. This 1977 Release, which concerns Regulation 14D, states that all financial information must be included in a Schedule 14D-1 when it is "material." Although the Release did not resolve all the ambiguities concerning materiality, it did point to several nonexclusive factors that the tender offeror should evaluate when disclosing financial information. Although case law provides few clear guidelines concerning disclosure requirements, courts have affirmed the heightened disclosure of 14D-1, reasoning that the required financial information may be material to a target shareholder in determining whether to tender because the shareholder may decide that it is more attractive to remain a minority shareholder under a new, and possibly more efficient, management.

Id. (citations omitted).

72. Christopher A. Iacono, Comment, *Tender Offers and Short-Form Mergers by Controlling Shareholders Under Delaware Law: The "800-Pound Gorilla" Continues Unimpeded – In Re Pure Resources, Inc., Shareholders Litigation*, 28 DEL. J. CORP. L. 645, 648-51 (2003).

Although the Williams Act does not define the term "tender offer", a tender offer is generally "an offer to shareholders of a corporation to purchase stock of that corporation." Often, the objective of the offer is to acquire control of that corporation. In return for the stock, the shareholder will usually receive as consideration either cash, stock, debentures, or stock warrants. Regardless of the consideration, typically a tender offer will be regarded as either friendly or unfriendly. A friendly offer is one where management of the target corporation (the

2. *The State Law*

While tender offers are regulated at the federal level under the 1934 Act and deal with issuer companies, there is also a body of takeovers law at the state level in the U.S. Furthermore, the federal and state laws are not necessarily removed from each other. There is a relationship between the two that adds some depth, but also interest, to the regulation of takeovers in the U.S. In looking at state regulation of takeovers law, the jurisdiction that commentators traditionally turn to

corporation whose stock is being sought) supports the offer, negotiates the terms, and recommends the offer to the shareholders. In contrast, an unfriendly offer, usually referred to as a takeover or a hostile takeover, occurs when the acquiring corporation has received or anticipates opposition by management of the target corporation. Because of this resistance, the most effective way for a corporation to accomplish its objective is to make an attractive offer to shareholders of the target corporation. A takeover may prove quite difficult for the acquiring corporation because it is forced to finance costly publicity campaigns to attract public tenders and may have to prepare for possible litigation.

The acquiring corporation may decide to make a tender offer to a specific target for a number of reasons. The corporation may have determined that the target is a good fit in terms of management compatibility that the two companies complement each other financially, or the target's potential has not been completely realized. Once the acquiring corporation determines that the potential target is a good purchase choice, it may directly approach the management of the target. Often prior to this, the acquiring corporation will attempt to buy stock in the target to secure itself a stronger bargaining position if its attempt at a friendly tender offer fails. If the corporation can obtain a majority of the shares and become the controlling shareholder prior to making a tender offer, the success of the offer is more likely.

If the acquiring corporation foregoes making a direct approach to the target's board or that approach is rejected, it will then commence the tender offer. The tender offer is an important tool for an acquiring corporation because it is made with a time limitation and is directed toward the target's shareholders. There is no requirement that the board of the target corporation approve the terms and conditions of a tender offer. In contrast, a merger or sale of asset transactions must get the board of directors' approval and recommendation.

Once a tender offer is made the target company must advise its shareholders of its position regarding the offer "no later than ten business days from the date the offer [was] 'first published, sent or given' to stockholders." Within that period, the target's board will review the offer with its advisors and may then recommend that the shareholders either reject or accept the offer, or advise them that they are unable to take a position on the offer. Regardless of their response to the offer, the target company must file their response in a Schedule 14D-9 form with the Securities and Exchange Commission prior to communicating it to its shareholders. As soon as the tender offer is made, however, the target's shareholders can choose to tender their shares immediately or wait for management's response.

Id. (citations omitted).

first is Delaware, as that is where the majority of public corporations are incorporated, and accordingly where there is an incredibly active market for corporate control.

In relation to Delaware law, Iacono provides a useful account of the mechanics of takeovers transactions.⁷³ Iacono goes on, discussing

73. *Id.* at 651-53.

Before making the tender offer, the acquiring corporation decides what form the offer will take: a cash offer, a stock exchange offer, or a combination of the two. In a cash tender offer, the acquiring corporation offers the target's shareholders cash for their shares in the company. In an exchange offer, however, the acquiring corporation offers its own shares in exchange for those of the target. Depending on the timing of the offer and the financial condition of the acquiring corporation, a cash offer may be more attractive to the target's shareholders.

Along with deciding the form of the offer, the acquiring corporation will determine the terms of the offer, including how many shares of the target's stock it wants acquire. The corporation will set a minimum or maximum amount of shares to acquire. If it is unsuccessful in obtaining that amount, the offer will be often withdrawn. A number of factors are considered when the corporation is determining the amount of shares to be sought, and sometimes it will set the number of shares at an amount that if successful, will allow it to complete a type of non-negotiated merger.

Under Delaware law, this type of merger between a parent and a subsidiary is referred to as a short-form merger. When a controlling shareholder corporation makes a successful tender offer for the necessary shares of its subsidiary, it will then complete a short-form merger.

B. Mechanics of a Short-Form Merger

Section 253 of the Delaware General Corporation Law (Section 253) authorizes and outlines the procedure for a short-form merger between a parent and its subsidiary. To qualify under Section 253, a parent corporation must own at least ninety percent of the outstanding shares of each class of stock of its subsidiary. The purpose of Section 253 "is to provide a parent corporation a means to eliminate unilaterally the minority stockholders' interest in the enterprise," and the procedures of a short-form are simple. After acquiring the required number through the tender offer, the board of directors of the parent corporation first adopts a resolution stating their intention to perform the merger. Then, the parent corporation files with the Secretary of State a "certificate of ownership and merger" which states that the parent owns at least ninety percent of the outstanding shares of the subsidiary corporation. Once the certificate is filed the merger is effective. Any shareholders who did not tender their shares receive compensation for them when the merger is conducted. A short-form merger has no requirement that the shareholders of either the parent or the subsidiary approve the merger; therefore, the parent corporation encounters no resistance in completing the merger.

C. Mechanics of a Section 251 Negotiated Merger

Rather than attempting to acquire the minority shares of the subsidiary by making a tender offer followed by a short-form merger, the controlling corporation may proceed through a negotiated merger with its subsidiary. Section 251 of the Delaware General Corporation Law (Section 251) grants the authority for a

2006] **Applicability of U.S. Takeovers Laws in Australia** 179

the different standards by which Delaware courts assess the involvement of coercion in takeovers transactions.⁷⁴

Another interesting aspect of takeovers regulation at the state level, particularly in Delaware, is the development of standards of review by the courts when considering defensive tactics by management of target companies. The question is whether the defensive tactic is employed with the interests of the target company's shareholders in mind, or to protect the positions of management responsible for devising the defensive tactic. Huang has recently provided a useful summary of this contentious area of the law, highlighting the precarious responsibilities of the fiduciary.⁷⁵

negotiated merger. Similar to a tender offer followed by a short-form merger, the result of the Section 251 merger is that the parent corporation absorbs the target; the target dissolves and the parent survives. The process of the negotiated merger, however, is extremely different from that of the tender offer/short-form merger. First, the board of both the parent corporation and the subsidiary must initiate the merger by adopting a plan of merger. The plan of merger outlines the terms and conditions of the merger, including the consideration that the target's shareholders will receive, such as shares of the parent corporation, or cash. After each corporation's board adopts the plan of merger, it is then submitted to the shareholders of both the parent and target. For the merger to be approved, a majority of the shares entitled to vote on the merger for each corporation must vote in its favor. Also unlike a tender offer, in a parent subsidiary merger, the controlling shareholders stand on both sides of the transaction. They are the parent acquiring corporation and the majority shareholder of the target. This presents an inherent conflict of interest because the minority shareholder will be forfeiting its shares for consideration, which is "determined as a result of a bargaining process in which the controlling shareholder [is] in a position to influence both bargaining parties."

In both of the transactions discussed above, a tender offer followed by a short-form merger or a Section 251 negotiated merger, the controlling shareholder, the parent corporation, owes a fiduciary duty to the minority shareholders when executing either transaction. . . .

Id. (citations omitted).

74. *Id.* at 656-57.

Delaware courts have applied a different and less exacting standard of review to tender offers made by controlling shareholders. In *Solomon*, the Delaware Supreme Court determined that absent coercion or materially false or misleading disclosures, a controlling shareholder is under no obligation to offer a certain price for the minority shares. The court recognized that tender offers are generally regarded as voluntary transactions; however, the court noted two situations where tender offers may be considered involuntary. The first is where the offer is coercive. The second is where the disclosures made by the controlling shareholders were materially false or misleading. If an offer is involuntary, then the court will apply the entire fairness standard. If neither coercion nor material non-disclosure are present, the tender offer will not be viewed under the exacting entire fairness standard.

Iacono, *supra* note 72, at 656-57. See also Jason A. Gonzalez, *Sunglasses: The Secret to Making Tender Offers Fashionable*, 1 N.Y.U. J. L. & BUS. 335, 338-40 (2005).

75. Huang, *supra* note 69, at 177-79.

In the U.S. takeover defense regime, as represented by Delaware law, the directors

of target corporations are empowered to institute a wide variety of defensive measures in response to hostile takeovers. Obviously, target management enjoys substantial discretionary power. In order to prevent target management from abusing their power to take defensive measures (for the sole purpose of entrenchment), U.S. takeover law imposes levels of judicial review depending on the perceived possibility of management opportunism. When target management adopts a defensive measure against a hostile bid, Delaware law applies the "modified business judgment rule" under which the directors are required "to show that after a 'good faith and reasonable investigation,' they saw a danger to corporate policy and effectiveness." In 1985, the Delaware Supreme Court decided a leading case regarding takeover defenses: *Unocal Corp. v. Mesa Petroleum Co.* In this case, the court made several important developments concerning the judicial review of target management's use of anti-takeover defenses. The court held that the board of the target corporation "has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders." Having established this general principle, the court then proceeded to articulate the directors' duties in the context of takeovers. According to this case, the defendants, namely the target company directors, are now required to show (1) "that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership," and (2) that "it [the defensive measure] must be reasonable in relation to threat posed." It is worth noting here that the defendant, not the plaintiff, bears the burden of proof. This makes judicial review act as a deterrent to abusive use of takeover defenses.

Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., further developed judicial review concerning the duties of target management when using defensive measures. Under *Revlon*, directors' duties will change once the board reasonably believes that the sale of the company is inevitable or the board takes steps to put the company up for sale. Upon this triggering situation, the directors must discharge their duties by obtaining the highest price for shareholders, rather than maintaining the corporate enterprise, and cannot adopt a defense for the purpose of giving absolute priority to a non-shareholder constituency.

Thus, the defenses permitted by *Unocal* could be a breach of the directors' fiduciary duty if the company is in the same situation as *Revlon*. Two subsequent cases, *Paramount Communications, Inc. v. Time, Inc.* and *Paramount Communications, Inc. v. QVC Network Inc.*, offered some guide to distinguish defensive transactions that put a company into a *Revlon* situation from transactions that do not. If a transaction contemplates a change in control of the target company, for example, by selling a control block of the target's stock to a single person or corporation, then the *Revlon* duty would be imposed on the target's management, otherwise only the *Unocal* duty would apply. In short, under Delaware law, the use of defensive measures is a matter within the business discretion of the target's directors and officer.

Id. (citations omitted). See also Bittlingmayer, *supra* note 53, at 732.

State law affects the voting rights of shareholders, the duties of corporate directors, and the defensive tactics available to target management, for example. This influence over the mechanics of control ultimately affects the value of control.

In contrast to state law, the influence of American federal law is less direct, though perhaps no less important.

Bittlingmayer, *supra* note 53, at 732.

2006] **Applicability of U.S. Takeovers Laws in Australia** 181

In relation to the law regulating defensive tactics in Delaware, another useful source is Stephen Bainbridge's recent article in the *Harvard Law Review*, which asserts that "the Delaware courts allow the target's board of directors a substantial gatekeeping role in unsolicited tender offers, which again is attributable to the court's recognition of the importance of preserving the board's authority."⁷⁶

II. THE WEIGHTY PRODUCT OF AUSTRALIAN TAKEOVERS LAW IN THE MARKET FOR CORPORATE CONTROL

A. *Towards Effective Marketing of the Product of Takeovers Law*

As has already been explained, this article is not about achieving change through the conventional process of law reform, but rather the effective marketing of a product – Australian takeovers law.

Given that this article is about marketing a product, and more specifically using principles of strategic marketing to manage the product of Australian takeovers law in the market for corporate control, we need to have at least a basic understanding of these concepts.

1. *Understanding of Marketing Generally*

In the field of *marketing*, there is an immense amount of material explaining this concept. According to Ulrich and Eppinger, marketing: (i) relates to interactions between firm and customer; (ii) facilitates identification of product opportunities, customer needs, and market segment definitions; and (iii) arranges for communication between firm and customer, sets price targets, and oversees product launch and promotion.⁷⁷

In his text, *Strategic Marketing Management*, Lambin defines marketing as "the process of delivering to the market."⁷⁸ Lambin conceives of marketing aspects, three-dimensionally: (i) active (the penetration of markets), (ii) analytic (the understanding of markets), and (iii) ideological (a market-oriented culture).⁷⁹

This article is concerned with both the analytic and ideological

76. Bainbridge, *Director Primacy*, *supra* note 47, at 1748. See also Bainbridge, *Unocal at 20*, *supra* note 57; Richard E. Kihlstrom & Michael J. Wachter, *Corporate Policy and the Coherence of Delaware Takeover Law*, 152 U. PA. L. REV. 523 (2003).

77. KARL T. ULRICH & STEVEN D. EPPINGER, *PRODUCT DESIGN AND DEVELOPMENT* 3 (3d ed., 2004).

78. JEAN-JACQUES LAMBIN, *MARKET-DRIVEN MANAGEMENT: STRATEGIC AND OPERATIONAL MARKETING* 7 (2000).

79. *Id.* at 4.

aspects of marketing. It is about first understanding the market for corporate control, and then fostering the operation of the market through a more flexible and efficient approach to takeovers regulation.

In this sense, the approach applied in this article involves being strategic in the way in which takeovers regulation is designed and presented to the market. It is about being strategic in relation to the regulation of takeovers, so that takeovers regulation is a more efficient and effective product in the market for corporate control.

There is a discrete area of marketing known as "strategic marketing" which is devoted to dealing with products in this way. According to Lambin, "[t]he objectives of strategic marketing typically include: a systematic and continuous analysis of the needs and requirements of key customer groups and the design and production of a product. . . that will enable the company to service selected groups or segments more effectively than its competitors."⁸⁰

2. Product Management

A product is "anything . . . that might satisfy a want or need."⁸¹ Product management is a discrete and specialized area of marketing that "is a function within a company dealing with the planning or marketing of a product or family of products at all stages of the product lifecycle."⁸²

John Legge explains in his book, *Product Management: Shaping the Competitive Edge*, that "product managers . . . play a key role in the success of the enterprises and in the promotion of growth in the wider economy."⁸³

What this article is intending to do is set out a "product strategy"⁸⁴ for takeovers regulation in Australia, which will inject greater flexibility and efficiency into Australian takeovers regulation through product engineering, rather than law reform.

We are concerned here with "product strategy" and development of a subtle process of "product engineering." Product management is about

80. *Id.* at 6.

81. Wikipedia, Product (Business), http://en.wikipedia.org/wiki/Product_%28business%29 (last visited Dec. 5, 2006).

82. Wikipedia, Product Management, http://en.wikipedia.org/wiki/Product_management (last visited Dec. 5, 2006).

83. JOHN LEGGE, *PRODUCT MANAGEMENT: SHARPENING THE COMPETITIVE EDGE* 1 (1999).

84. See DONALD R LEHMANN & RUSSELL S. WINER, *PRODUCT MANAGEMENT* Ch 8 (4th ed. 2005).

improving the “quality” of the particular product on offer.⁸⁵ Improved “quality” is also an objective in this article – improving the quality of takeovers regulation without law reform.

Legge explains that improving the quality of the “product,” whether this be takeovers regulation or something else, comes from being innovative. According to Legge, “[i]nnovations that introduce new qualities of products [promote growth]. As with absolutely new products, the successful introduction of a new quality of an established product will attract customers, this time away from the old, lower value-for-money product.”⁸⁶

In discussing the concept of quality, Legge provides credence to the Japanese technique of “quality function management.” This derives from the idea that “quality means producing customer satisfaction, and the job of product development is to create (or ‘deploy’) product functions in order to create quality.”⁸⁷

In applying principles and concepts in marketing to rethink how we should approach takeovers regulation, it is useful to think of takeovers regulation in Australia as being a “product” operating in a “contestable market.”⁸⁸ While the formal legal rules regulating corporate control transactions enjoy monopoly status in the market for corporate control (aside from the “competition” between Chapter 6 bids and schemes), it is important for the “product” to remain attractive through being efficient and effective.

According to conventional economic theory, in some circumstances (private) monopolies are forced to behave as if they were subject to competition because of the risk of losing that monopoly to new entrants, or because of the availability in the longer term of substitutes in other markets. Approaching the regulation of takeovers as a product in such a contestable market may be useful to encourage innovation.

Harvard Business School’s Michael Porter wrote in his acclaimed book, *The Competitive Advantage of Nations*, that a government’s role in a market is to act as “pusher” and “challenger” so that firms gain a

85. See BEYOND BRANDING (Nicholas Ind, ed., 2003); ROBERT BLAICH & JANET BLAICH, PRODUCT DESIGN AND CORPORATE STRATEGY: MANAGING THE CONNECTION FOR COMPETITIVE ADVANTAGE (1993); DONALD R. LEHMANN & RUSSELL S. WINER, PRODUCT MANAGEMENT (4th ed. 2001); ROBERT G. COOPER ET AL., PORTFOLIO MANAGEMENT FOR NEW PRODUCTS (2d ed. 2001).

86. LEGGE, *supra* note 83, at 5.

87. *Id.* at 48.

88. See, e.g., WILLIAM J. BAUMOL, JOHN C. PANZAR & ROBERT D. WILLING, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (rev. ed. 1988).

competitive edge.⁸⁹

I believe that the government's role in the market for corporate control is as a "pusher" of a flexible and efficient product of takeovers regulation as if the takeover laws are a product in a contestable market (competing with the market itself).

B. Honey, I Didn't Shrink the Takeovers Code: The Chapter 6 Unfriendly Giant

In other product markets, it is recognized that there is little virtue in producing a large and unwieldy product when a smaller design can achieve the same, or a substantially similar, function. Indeed, a smaller design usually makes the product more effective.

Yet, in Australia we have a relatively enormous takeovers code (Chapter 6 of the *Corporations Act*) to regulate a relatively small market for corporate control. Applying a cost-benefit analysis and judging the regulation through the lens of economic efficiency, Australia's approach to takeovers regulation is troubling.

Add to this the extra fact, discussed further below, that combined with the takeovers code, Australia has additional schemes of arrangement regime for regulating takeovers. Despite being placed in a separate part of the corporations legislation to the takeovers code, you would think that there is a fundamental justificatory reason why the corporate regulator, ASIC, has facilitated a dual system of takeovers regulation. But this assumption is wrong.

While there are certain commercial benefits which can be derived from pursuing a scheme of arrangement compared to traveling down the takeovers code road, we should not assume that schemes are indispensable. They are not.

Further below, it is suggested that the separate scheme of arrangement regime, as it operates in the market for corporate control, should be abandoned. This does not require legislative change, but a simple reversal of questionable ASIC policy that schemes can be used for takeovers. Accordingly, it is suggested that Chapter 6 should stand by itself as a single, self-contained product for regulating takeovers in the market for corporate control.

This will not result in any disadvantage. All the commercial and regulatory benefits that schemes were thought to have in their exclusive domain will be maintained. There is no magic to a "scheme" that cannot be achieved through an alternative "arrangement." Indeed, more

89. MICHAEL E. PORTER, *THE COMPETITIVE ADVANTAGE OF NATIONS* (2d. ed. 1998).

than this, as will be explained, all the benefits will be preserved, while some of the costs associated with schemes will be avoided.

While the courts will no longer have a central role in the regulation of corporate control transactions, which they do at present for schemes of arrangement, it is envisaged that a makeover of the takeovers code, principally through improving the "quality" of § 611(7) within Chapter 6, will protect shareholders through a supervisory role by ASIC (which essentially already is in place in the schemes and takeovers process), and the jurisdiction of the Takeovers Panel when issues of control arise to hear and determine complaints of "unacceptable circumstances."

1. *Introduction to the Chapter 6 Code*

As to the basic principles of Australian takeovers regulation, contained in Chapter 6 of the *Corporations Act*, *Ford's Principles of Corporations Law* describes the parameters of corporate control and restructuring transactions.⁹⁰ *Ford's* also explains how Chapter 6 will impose blanket prohibitions, under certain circumstances, subject to specific gateway procedures and exemptions.⁹¹

The last gateway mentioned is the focus of this article, and will be explored in detail below when discussing § 611(7) and how it can be used to inject greater flexibility into the market. The rest of Chapter 6, with its 50 odd sections taking up dozens of pages in the *Corporations*

90. AUSTIN & RAMSAY, *supra* note 54, at 23.040.

The takeovers which are regulated under Chapter 6 of the *Corporations Act* are corporate control or restructuring transactions involving an acquisition of voting shares by a bidder in a target company which has more than 50 members. The policy reflected in the *Corporations Act* is that an acquisition which allows the bidder to influence more than 20% of the voting shares in the target should be subject to regulatory supervision. Once the bidder has reached the 20% threshold, further acquisitions should be supervised until 90% of the target has been acquired.

Id. For a useful overview of the law regulating takeovers in Australia, see Tony Damian & Andrew Rich, *Schemes, Takeovers and Himalayan Peaks: The Use of Schemes of Arrangement to Effect Change of Control Transactions* 6-8 (2004); I. Renard & J.G. Santamaria, *Takeovers and Reconstructions in Australia*, looseleaf service.

91. See AUSTIN & RAMSAY, *supra* note 54, at 23.090.

Chapter 6 of the *Corporations Act* seeks to regulate takeovers by imposing a blanket prohibition on acquisitions beyond the 20% threshold, unless certain gateways and exemptions are used. The principal (but by no means the only) means of lawfully exceeding the 20% threshold are:

- by making offers under an off-market bid;
- by making offers under a market bid;
- by acquiring not more than 3% of the voting shares of the target in any period of six months; and
- by making the takeover after shareholder approval.

Id.

Act, essentially builds on this position.⁹²

2. Eggleston Principles

The most important provision in Chapter 6 is § 605, which expresses the purposes of the Chapter, including the so-called 'Eggleston principles.'⁹³ These purposes form the basis for the specific provisions taking up the pages of Chapter 6, and also are consulted by the Takeovers Panel in determining whether to make a declaration of "unacceptable circumstances."⁹⁴ The function of the Takeovers Panel in Australia is explained below.

Ford's states that, "[m]uch of the statutory regulation is designed to ensure that the takeover bid proceeds in accordance with the Eggleston principles and in particular, that the target shareholders are accorded equality of opportunity."⁹⁵

The principles, known as the 'Eggleston principles,' emerged from recommendations in a 1969 report of the Company Law Advisory Committee, chaired by Richard Eggleston.⁹⁶

92. REDMOND, *supra* note 61, at 898. As Paul Redmond notes:

The central provision in Australian takeover regulation, that gives technical effect to the regulatory goals, is contained in Section 606(1). However, the person may acquire the relevant interest under one of the exceptions set out in Section 611 without contravening Section 606, Section 606(1)(A). The prohibition acts as a takeover threshold, stopping anyone crossing its barrier of 20 percent of voting power by share acquisition unless they do by means of one or more of the sanctioned paths each of which pays its respects to the Eggleston principles.

Id.

Section 606(1) of the Act provides:

A person must not acquire a relevant interest in issued voting shares in a company if:

(a) the company is:

- (i) a listed company; or
- (ii) an unlisted company with more than 50 members; and

(b) the person acquiring the interest does so through a transaction in relation to securities entered into by or on behalf of the person; and

(c) because of the transaction, that person's or someone else's voting power in the company increases:

- (i) from 20% or below to more than 20%; or
- (ii) from a starting point that is above 20% and below 90%

Corporations Act, 2001, § 606(1) (Austl.).

93. REDMOND, *supra* note 61.

94. See Benedict Sheehy, *Australia's Eggleston Principles in Takeover Law: Social and Economic Sense?*, 17 AUSTL. J. CORP. L. 218 (2004).

95. See AUSTIN & RAMSAY, *supra* note 54, at 23.350. For a useful discussion on the "principles shaping Australian takeover regulation," see also REDMOND, *supra* note 61, at 887-89.

96. See THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA, CO. LAW ADVISORY

Ford's also summarizes the purposes of Chapter 6, now expressed in § 602 of the Act. The authors comment that the purpose of Chapter 6 is to ensure: (i) efficient, competitive, and informed market acquisitions; (ii) proper extent of disclosure and time to utilize the information; (iii) reasonable and equal participation, by voting shareholders, in the benefits accruing to them; and (iv) execution of appropriate procedures.⁹⁷

In the Australian Government's Corporate Law Economic Reform Program (CLERP) 4 policy document,⁹⁸ titled *Corporate Control: A Better Environment for Productive Investment*, released in 1997, it is stated that the "Eggleston principles provide the philosophical underpinning" for the current takeover rules.⁹⁹ Redmond notes that the extent to which these principles have influenced Australian takeovers

COMM. TO THE STANDING COMM. OF ATTY'S-GEN., 2D INTERIM REPORT, PARL. PAPER NO. 43 (1969), available at <http://www.takeovers.gov.au/display.asp?ContentID=494> (last visited Nov. 24, 2006). See also AUSTIN & RAMSAY, *supra* note 54, at 23.060. *Ford's* comments that:

The Eggleston Committee expressed the opinion that where there is a proposal pursuant to which a bidder would acquire a substantial interest, it is necessary to ensure that:

- (1) the shareholders are carefully informed, and in particular that they have knowledge of:
 - (a) the bidder's identity; and
 - (b) all matters which may be relevant to the merits of the proposal;
- (2) the shareholders have sufficient time reasonably to assess the merits of the proposal; and
- (3) as far as practicable, all shareholders have an equal opportunity to share in any benefits accruing to any shareholder under the proposal. [This is the most controversial part.]

Id.

97. AUSTIN & RAMSAY, *supra* note 54, at 23.080. Chapter 6 ensures:

First . . . that the acquisition of rights over voting shares takes place in an efficient, competitive and informed market. . . . Second, a purpose of Chapter 6 is to ensure that the holders of shares and interests and also the directors of the company or the responsible entity for the scheme, know the identity of the person who proposes to acquire a substantial interest, have reasonable time to consider the proposal and are given enough information to enable them to assess the proposal's strengths and merits: s 602(b). . . . Third, it is a purpose of Chapter 6 to ensure, as far as practical, that the holders of the relevant class of voting shares and interests all have a reasonable and equal opportunity to participate in any benefits accruing through the proposals: s 602(c). . . . Finally, a purpose of Chapter 6 is to ensure that "an appropriate procedure" is followed as a preliminary to compulsory acquisition of voting shares or interests of any other kind of securities under Part. 6A.1 s 602(d).

Id.

98. COMMONWEALTH OF AUSTRALIA, CORPORATE CONTROL: A BETTER ENV'T FOR PRODUCTIVE INV. (1997), <http://www.treasury.gov.au/documents/284/PDF/full.pdf> (last visited Nov. 24, 2006) [hereinafter CLERP 4 Policy].

99. *Id.* at 10.

laws,¹⁰⁰ Justin Mannolini has also written that the principles arising out of the Eggleston report still provide the “conceptual grundnorm” for the operation of Australia’s takeovers law.¹⁰¹

3. *The Protective Function of the Takeovers Panel*

An important feature of takeovers regulation in Australia is the role of the Takeovers Panel. The Takeovers Panel, constituted in its present form since 2000, endeavors to resolve disputes in a prompt and commercially-focused way.¹⁰² It may also issue a declaration of “unacceptable circumstances” in relation to conduct involving a corporate control transaction- regardless of whether there is a breach of the takeovers legislation.¹⁰³

The principles contained in § 602 are at the heart of what the Takeovers Panel does. The Panel does, and must by law, turn to the principles in determining whether to issue a declaration of “unacceptable circumstances.”¹⁰⁴ Section 657A(3) of the *Corporations Act* states that:

[I]n exercising its powers under this section, the Panel:

(a) must have regard to:

(i) the purposes of this Chapter set out in section 602;

(ii) the other provisions of this Chapter¹⁰⁵

The important part of § 657A(1) states that: “[t]he Panel may declare circumstances in relation to the affairs of a company to be

100. REDMOND, *supra* note 61, at 887-88

These principles have had a profoundly shaping effect upon Australian takeover law, especially through their inclusion in the statement of the purposes of Chapter 6, namely, to ensure that acquisition of control over listed companies or those with more than 50 members, takes place in an efficient, competitive and informed market and conditions corresponding to the four Eggleston principles are satisfied whenever a person would acquire a substantial interest in the company: § 602.

Id. See also *id.* at 889 (“The first three principles are essentially concerned with the bid process and protection against crude forms of coercion or deception. The fourth principle asserts the claims of distributive justice, in the sense of fair or equal treatment of target shareholders, against those of allocative efficiency.”).

101. Mannolini, *supra* note 7, at 337.

102. See NICOLE E. CALLEJA, *THE NEW TAKEOVERS PANEL: BETTER WAY? 2* (2002). See also RODD LEVY, *TAKEOVERS: LAW & STRATEGY* ch. 17 (2d ed. 2002) (discussing powers of ASIC, the Takeovers Panel and the Court). See *id.* at 240-48, for a discussion of the Takeovers Panel.

103. See CALLEJA, *supra* note 102. See also LEVY, *supra* note 102.

104. See *Corporations Act*, 2001, No. 50, § 657A(3) (2001) (Austl.).

105. *Id.*

unacceptable circumstances. Without limiting this, the Panel may declare circumstances to be unacceptable circumstances whether or not the circumstances constitute a contravention of a provision of this Act.”¹⁰⁶ This is very relevant conduct that occurs under the § 611(7) arrangement because of the emphasis in § 602 on investor protection.

Section 657A, and in particular the fact that the Panel can make a declaration of unacceptable circumstances even if the relevant conduct does not constitute a contravention of the Act, will become important when discussing the proposed reinvigoration of § 611(7) below. The website of the Takeovers Panel (www.takeovers.gov.au) is also a useful source of information concerning the role of the Panel.¹⁰⁷

In relation to § 657A, mentioned above, and the Takeovers Panel’s powers to issue a declaration of unacceptable circumstances, the Panel has issued a series of so-called “guidance notes” indicating how it intends to exercise its powers under the Act. Guidance Note 1, available on the Panel’s website, outlines the factors to be considered by the Panel when determining whether to make a declaration of

106. *Id.* § 657A(1).

107. Takeovers Panel Homepage, <http://www.takeovers.gov.au/> (last visited Dec. 6, 2006). On the website, it is explained that:

The Takeovers Panel is the primary forum for resolving disputes about a takeover bid until the bid period has ended. The Panel is a peer review body, with part time members appointed from the active members of Australia’s takeovers and business communities.

The Panel is established under section 171 of the Australian Securities and Investments Commission Act (the ASIC Act). It is given various powers under Part 6.10 of the Corporations Act.

.....
The panel has the power to make orders to protect the rights of persons (especially target company shareholders) during a takeover bid and to ensure that a takeover bid proceeds (as far as possible) in a way that it would have procured if the unacceptable circumstances had not occurred.

.....
The policy principles that the Panel aims to advance are those set out in §602 of the Act. They essentially include the four ‘Eggleston Principles’ and an additional principal [sic] that the acquisition of control of listed companies or listed managed investment scheme, take place in an efficient, competitive and informed market.

Takeovers Panel, About the Panel, <http://www.takeovers.gov.au/display.asp?ContentID=6> (last visited Dec. 6, 2006). According to the Explanatory Memorandum to the Bill that established the reinvigorated Takeovers Panel, the intention was for the Panel to “take the place of the courts as the principal forum for resolving takeover disputes under the Corporations Law, with the exception of civil claims after a takeover has occurred and criminal prosecutions.” House of Representative, Corporate Law Economic Reform Program Act Explanatory Memorandum (Takeovers), 1999, at ¶7.3 available at http://law.ato.gov.au/atolaw/view.htm?DocID=NEM%2FEM_199959%2FNAT%2FATO%2F00007 (last visited Dec. 6, 2006).

unacceptable circumstances.¹⁰⁸

4. Takeovers and Corporate Law Economic Reform

The reforms made to the *Corporations Act* in 2000, which involved a redrafting of Chapter 6 and the introduction of a reinvigorated Takeovers Panel, were explicitly designed to “simplify” the regulation of takeovers, and make takeovers regulation more “efficient.” As has been pointed out numerous times to date, this is also the objective behind the ideas expressed in this article.

The reform of the takeover provisions was regarded by the government as a fundamental part of its economic policy. This is because takeovers, and the potential for takeovers through an effective system of regulation, has a disciplining effect on management and therefore works to enhance efficiency. In applying economic considerations to the regulation of takeovers in Australia, the thinking in “law and economics,” discussed earlier, becomes very relevant.¹⁰⁹

The economic basis for the most recent renovation of the takeovers law, was explained in detail in the Department of Treasury’s CLERP 4 policy paper, which preceded the reforms.¹¹⁰ According to the paper, the CLERP “brings an economic focus to corporate law reform and aims to ensure that the Corporations Law facilitates investment, while maintaining confidence in the business environment and protecting investors.”¹¹¹

108. Takeover Panel, Guidance, Guidance Note 1: unacceptable circumstances, <http://www.takeovers.gov.au/display.asp?ContentID=837> (last visited Dec. 5, 2006) [hereinafter Guidance Note 1]. Further, it was stated that the Panel is to be a “specialist body largely comprised of takeover experts,” who will resolve takeover disputes as quickly and effectively as possible, “on the basis of their commercial merits,” and thereby minimize tactical litigation. HOUSE OF REPRESENTATIVE, *supra* note 107. See generally Emma Armson, *An Empirical Study of the First Five Years of the Takeovers Panel*, 27 SYDNEY. L. REV. 665 (2005); Emma Armson, *The Australian Takeovers Panel: Commercial Body or Quasi-Court?*, 28 MELB. U. L. REV. 565 (2004).

109. AUSTIN & RAMSAY, *supra* note 54, at 23.080. According to FORD’S PRINCIPLES: . . . [t]he reform of the takeover provisions by the CLERP Act 1999 was regarded by the government as a fundamental part of its economic policies. . . . Takeovers were said to promote efficiency in the capital market because the threat of takeover provides a strong incentive for corporate management to use capital efficiently, and conversely, failure to use a company’s capital efficiently is likely to be reflected in an under-performing share price and hence vulnerability to takeover. Consequently, it was said, if a takeover occurs, it should result in resources being allocated to a more productive use.

Id.

110. COMMONWEALTH OF AUSTRALIA, *supra* note 98.

111. *Id.* at 5.

2006] **Applicability of U.S. Takeovers Laws in Australia** 191

Accepting the general economic approach underpinning the CLERP, the policy paper then focused on the Government's vision for takeovers regulation:

This paper sets out proposals for reform of takeover[s] regulation under the Corporations Law. The reforms aim to remove regulatory impediments to an efficient market for corporate control subject to ensuring a sound investor protection regime. . . .

The basic objective of takeover regulation is to improve market efficiency. Specifically, regulation is directed at achieving an appropriate balance between encouraging efficient management and ensuring a sound investor protection regime, particularly for minority investors. . . . All regulation involves some cost and it is essential to ensure that the benefits from regulation outweigh consequential costs.¹¹²

C. Time to Clean Out The Attic: The Antiquated Schemes of Arrangement Regime

As was noted above, the second (and probably less well known) part of the dual structure regulating corporate control transactions in Australia is the scheme of arrangement. While the use of schemes to effect corporate control transactions has grown over time, schemes are still more limited in scope because they can only be used in "friendly" mergers. Schemes cannot be used for so-called hostile takeovers. Hostile takeovers are still the exclusive domain of Chapter 6.

According to Damian and Rich, in the four years from 1996 to 1999, schemes constituted 40% of "friendly" deals (deals valued at over \$200 million each). From 2000 to 2003, the proportion was 38%.¹¹³

What follows is an explanation of the law regulating schemes, and how schemes are used for corporate control transactions.

In the author's view, there is no mystery behind schemes of arrangement;¹¹⁴ they are simply just another form of regulated agreement- this time, between a company and its shareholders, or between a company and its creditors. The focus in this article is on a shareholders' scheme of arrangement.¹¹⁵

In Australia, schemes of arrangement are regulated predominantly

112. *Id.* at 5, 7.

113. See DAMIAN & RICH, *supra* note 90, at 93.

114. James McConvill, *Schemes of Arrangement, Selective Buy-Backs & Village Roadshow's Preference Share Tussle: Entering the Matrix*, 2 MACQUARIE J. BUS. L. 203, 205 (2005), available at http://www.law.mq.edu.au/html/MqJBL/vol2/vol2_9.pdf.

115. For a useful discussion of the practical aspects of shareholder schemes, see DAMIAN & RICH, *supra* note 90, at ch. 5.

through Part 5.1 of the *Corporations Act*, along with Regulation 5.1 and Schedule 8, Part 3 of the *Corporations Regulations* (which sets down the procedural rules for the scheme).¹¹⁶ "Arrangement" is defined very widely for the purposes of the *Corporations Act* (section 9 talks of "arrangement" to include "a reorganization of [the] share capital of the body corporate by the consolidation of shares of different classes").¹¹⁷ This essentially means any reorganization of the company affecting the rights or interests of shareholders, for which there are not special provisions in the *Corporations Act* dictating how this should be done.¹¹⁸ For instance, Part 2J of the Act, which deals with share buy-backs and reductions of capital, and § 254H which regulates the conversion of all or any of a company's shares into larger or smaller amounts.¹¹⁹

In recent times, schemes of arrangement to achieve a merger of two companies have become more common. This is mainly due to the fact the offering company only has to achieve 75% of votes in support of the merger proposal to be legally entitled to acquire the shares of dissentient shareholders. However, with a formal takeover bid initiated under Chapter 6 of the Act, a bidder company has to achieve at least 90% support in order to "mop up" the remaining shares pursuant to the compulsory acquisition provisions under Chapter 6A of the Act.¹²⁰

A merger scheme of arrangement is an agreement between the target company, meaning the company proposed to be acquired, and its shareholders. Usually, the offeror company is substantially involved in the merger. The shareholders agree to be issued with shares in the offeror company, often along with a certain cash amount or some other monetary arrangement, as consideration for the cancellation of their shares in the target company.¹²¹ Because a merger scheme is structured in this way, it is only available for "friendly" mergers because the target

116. *Corporations Act*, 2001, pt. 5.1 (Austl.); *Corporations Regulations*, 2001, pt. 5.1, sched. 8, pt. 3 (Austl.).

117. *Corporations Act*, 2001, § 9 (Austl.); see also *Re NRMA Ltd.* (2000) 33 A.C.S.R. 595, 606 (N.S.W.) (referring to comments of Santow J as to the wide scope of "arrangement").

118. See *Australian Sec. Comm'n v. Marlborough Gold Mines Ltd.* (1993) 177 C.L.R. 485; see also Kanaga Dharmanada & Justin Harris, *End of the Schemer's Scheme: Limitations on Use of Schemes of Arrangements*, 14 *COMPANY & SEC. L.J.* 509 (1996).

119. *Corporations Act*, *supra* note 116, pt. 2J, § 254H.

120. For a recent discussion of the operation of Chapter 6A, see Joylon Rogers, *Compulsory Acquisition under Part 6A.2 and its implications for Minority Shareholders*, 31 *AUSTL. BUS. L. REV.* 97 (2003); Glenn Hughes, *Compulsory Acquisition of Minority Shareholders' Interests*, 18 *COMPANY & SEC. L.J.* 197 (2000).

121. See also Alberto Colla, *Schemes of Arrangement as an Alternative to Friendly Takeover Schemes: Recent Developments*, 16 *COMPANY & SEC. L.J.* 365 (1998).

board must agree to put the resolution to its shareholders.

Schemes of arrangement can also be used for “de-mergers” (also referred to as “spin-offs”) whereby the shareholders of a large company agree for the company to be divided into two or more separate companies. The purpose of de-mergers is to “unlock” hidden value in the company and to establish companies with particular areas of specialization. Examples of where schemes of arrangement were used for this purpose include the WMC de-merger in 2002 and the AMP de-merger in 2003.

Schemes of arrangement are typically used by companies when there is a risk that not all shareholders will support the particular reorganization that is proposed. For a scheme of arrangement to come into force, it is only necessary for 75% of the votes cast at a scheme meeting to support the proposal.¹²²

The procedural requirements which govern a shareholders’ scheme of arrangement are set down in § 411 of the *Corporations Act*. The key procedural feature of a scheme of arrangement, as highlighted by § 411, is that a scheme is heavily supervised by the Court. A company cannot hold a meeting of its shareholders to consider a scheme of arrangement, send out information to shareholders about the scheme of arrangement, or implement a scheme of arrangement, without the approval of the Court each time. Thus, the concept of “arrangement” is very flexible such that schemes of arrangement can be used for a wide range of purposes by companies because of the involvement of the court at each step of the § 411 process and because the work that must go into preparing the scheme so that the Court ultimately approves of it, schemes of arrangement can be an extremely costly and time-consuming mechanism to effect a change of corporate control.¹²³

Under § 411, the first step is for the company to prepare an explanatory statement (setting out, at the minimum, the matters listed in Schedule 8, Part 3 of the *Corporations Regulations*), to be included in a ‘scheme booklet’ which is designed to assist shareholders by setting out all of the material information regarding the scheme and its effect on the shareholders. Often, a scheme booklet will include an “independent expert’s report,” which states whether or not (in the expert’s opinion) the scheme is in the best interests of the company’s shareholders. Regulations 8303-8306 of the *Corporations Regulations* require an expert’s report to be prepared if the outside party is (e.g. the company

122. COLLA, *supra* note 121.

123. *Id.*

wanting to acquire the target) involved in a scheme has a 30% or more shareholding in the company, or if the outside company and the scheme company have common directors.¹²⁴ However, common practice is for a company to include such a report even if it is not required by law.¹²⁵

Once prepared, this booklet is lodged with ASIC (at least 14 days before the first court hearing), who will review it to assess whether it complies with the requirements of the Act. Following this, a first court hearing is held, whereby the company asks the Court for an order permitting it to convene a shareholders' meeting to both consider and vote on the scheme. So long as all the necessary procedural and substantive steps have been complied with by the company, the Court will usually allow the company to convene a scheme meeting.¹²⁶

The company must then send out a notice of meeting to shareholders, accompanied by a copy of the scheme booklet. So that shareholders are capable of consulting at the scheme meeting with other shareholders who have a sufficiently similar interest in the company to them, the company will arrange (where necessary) separate meetings for different classes of shareholders (e.g. ordinary shareholders, preference shareholders, option holders etc). This is because § 411(1) of the Act speaks of a meeting of members or "classes of members" being held. The test for determining if shareholders are assembled into appropriate classes is whether the impact of the scheme on the legal rights of each particular group (as opposed to their commercial interests arising out of the scheme) is sufficiently similar to make it possible for them to consult together "with a view to their common interest."¹²⁷

The shareholders vote on the scheme at the court sanction meeting. For the resolution adopting the scheme to succeed, it must be approved by 50% or more of the number of shareholders present and voting, and by at least 75% of the votes cast on the resolution. If separate classes of shareholders have been arranged, then each class must approve the resolution by the "50% in number, 75% in value" test.¹²⁸

124. Corporations Regulations, 2001, vol.10, sched. 8, §§ 8303-8306 (Austl.), available at <http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrumentCompilation1.nsf/fra melodgementattachments/83659C7524DCC753CA2571850004498B>.

125. See Alberto Colla, *Has the Greenmailer Finally Been Eradicated from Australian Corporate Law?*, 20 COMPANY & SEC. L. J. 318, 332 (2003) [hereinafter *Greenmailer Eradication*]; see also IAN RAMSAY, JON WEBSTER, LAURIE McDONALD & GRANT MOODIE, EXPERTS' REPORTS IN CORPORATE TRANSACTIONS 4 (2003).

126. *Id.*

127. See *Sovereign Life Assurance Co. v. Dodd* (1892) 2 Q.B. 573, 583.

128. See *Greenmailer Eradication*, *supra* note 125, at 332-33.

2006] **Applicability of U.S. Takeovers Laws in Australia** 195

If the resolution is approved by the requisite numbers, the company then goes back to the Court for final approval of the scheme pursuant to § 411(4)(b) of the Act. The Court will look at the extent of shareholder approval, and will consider whether the terms of the scheme are “fair and reasonable” based on the opinion of an “honest and intelligent” business person.¹²⁹ It is very, very rare for the court to reject a scheme where the “50% in number, 75% in value” test has clearly been satisfied – as it is hesitant to substitute its decision for the commercial decision made by the shareholders.¹³⁰

An important point to note is that ASIC has a large role to play in relation to schemes. It invests a great deal of time and resources in examining the terms of the scheme and the requisite explanatory statement, and in making appropriate submissions to the Court. Once shareholders approve the scheme according to the requisite threshold, shareholders are bound by the arrangement. They cannot act inconsistently with the arrangement, and the company can mop up remaining shares through a simultaneous reduction of capital resolution.¹³¹

1. *The Stupidity of § 411(17)*

A crazy thing about the operation of schemes in the context of control transactions is that the corporate regulator, ASIC, has sanctioned the regulation of takeovers through two separate mechanisms, Part 5.1 and Chapter 6, even though Chapter 6 is specially designed to regulate takeovers.¹³² What makes this even crazier is that this dual system is allowed to go on,¹³³ but schemes are subject to, and cannot depart from, the protections in § 602.¹³⁴ This is because of § 411(17) of the Act.¹³⁵

129. *In re Chevron (Sydney) Ltd.* (1963) V.R. 249.

130. *Greenmailer Eradication*, *supra* note 125.

131. See AUSTIN & RAMSAY, *supra* note 54, at 23.010. *Ford's Principles of Corporations Law* explains that:

[t]ypically a scheme of arrangement is a plan by which a company is recognized in some way which affects members' rights or interests. The scheme typically has elements that are compulsory for members, such as a requirement that all members transfer their shares in exchange for shares in a new holding company: *Re Victorian Grain Services Ltd* (2000) 35 ACSR 198. . . .

Id. See Colla, *Schemes of Arrangement*, *supra* note 121 (overview of schemes); DAMIAN & RICH, *supra* note 90, at 8-20 (overview of the scheme procedure).

132. See DAMIAN & RICH, *supra* note 90.

133. The Australian Department of Treasury concluding in relation to schemes that: “The current approach to takeovers by scheme of arrangement should be retained. This would continue to allow schemes to be used to transfer control of a ‘target’ company to a ‘bidder’ company.” CLERP 4 Policy, *supra* note 98.

134. Corporations Act, 2001, § 602 (Austl.).

Section 411(17), which commenced on 1 July 1982, prevents the court from approving a scheme unless:

- (a) it is satisfied that the scheme has not been proposed for the purpose of enabling any person to avoid the operation of Chapter 6 (which regulates takeovers); or
- (b) the Commission states in writing to the court that it has no objection to the compromise or arrangement. The Court need not approve the scheme merely because of the Commission's statement.¹³⁶

ASIC's position on the use of schemes in the context of takeovers is clarified to some extent in its Policy Statement 60, which has been applied since the early 1990s.¹³⁷

ASIC also states that, "many transactions which cannot be effected under a Chapter 6 takeover without modification may be effected under Chapter 5 or, simultaneously with a Chapter 5 resolution."¹³⁸ For example, the following transactions cannot be achieved by making takeover offers alone:

- (a) amendments of articles of association;
- (b) reductions of capital;
- (c) acquisitions of, and variation of the terms of, options and convertible securities.¹³⁹

When considering § 411(17), ASIC Policy Statement 142 is also relevant. Policy Statement 142 discusses that in relation to the ASIC statement under § 411(17)(b) that ASIC has no objection to the scheme:

135. Corporations Act, 2001, § 411 (17) (Austl.).

136. *Id.*

137. See ASIC, Policy Statement 60, PS 60.3 (Apr. 8, 1999), available at <http://services.thomson.com.au/asic/ps/ps060.pdf> (last visited Nov. 30, 2006) [hereinafter ASIC, Policy Statement 60]:

ASIC's policy on transactions that can be conducted either as schemes or takeovers is that ASIC and the Law have no preference for these transactions being conducted one way or another. It is not the purpose of the Law to require persons to follow the procedures set out in Chapter 6 (in preference to other regulated methods) in the case of all transactions involving acquisitions (In Re The Bank of Adelaide (1979) 22 SASR 481; Re ACM Gold Ltd (1992) 7 ACSR 231; Re Stockbridge Ltd).

There are recent cases which reflect the position expressed by ASIC in PS 60. See Re Equinox Resources Ltd, (2004) 49 ACSR 692, at 19 ("the takeovers provisions of Chapter 6 will not be regarded as having dominance over, or as automatically taking precedence over, the scheme provisions of Chapter 5."). See also Re Crown Diamonds NL, (2005) W.A.S.C. 93 (Austl.).

138. ASIC, Policy Statement 60, *supra* note 137, at PS 60.4.

139. *Id.*

ASIC is concerned to ensure that takeovers that operate by way of schemes of arrangement operate, and are regulated, in a manner which is harmonious with the provisions of Chapter 6. This requires that members receive all material information that they need for their decision, members receive reasonable and equal opportunity to share in the benefits provided under the scheme, and the meetings are properly conducted. ASIC will not provide a statement under § 411(7)(b) unless the scheme and its explanatory statement meet these conditions.¹⁴⁰

In their recent monograph *Schemes, Takeovers and Himalayan Peaks*, Damian and Rich recommend that § 411(17) be repealed so that schemes have a completely separate operation to Chapter 6 in the context of corporate control transactions.¹⁴¹ It is my view, however, that schemes should no longer operate in the terrain covered by Chapter 6.

If § 411(17) is to be repealed, which this article is not suggesting, it should only be because schemes are no longer relevant to corporate control transactions. As will be explained in section four, while using schemes has certain benefits, these can be obtained through a self-contained Chapter 6, which is reinvigorated through fresh thinking. Section 611(7) of the Corporations Act is the key to making this happen.

2. *Advantages and Disadvantages of Schemes*¹⁴²

It is noted below that I believe takeovers regulation in Australia can do without the involvement of schemes. Rather than have a dual regulatory scheme for corporate control transactions of schemes and formal Chapter 6 bids, I believe Chapter 6 should stand alone as a self-contained mechanism.

But if the use of schemes is so problematic in the context of corporate control transactions, why are they commonly used? There have been some attempts recently, in particular in the Damian and Rich monograph, to clearly identify the benefits of schemes. Some of the costs of using schemes have also been identified. These are pointed out below.

140. ASIC, Policy Statement 142, PS 142.19 (Apr. 8, 1999), available at <http://services.thompson.com.au/asic/ps/ps142.pdf> (last visited Nov. 29, 2006).

141. See DAMIAN & RICH, *supra* note 90, at Chapter 7. Damian and Rich also propose that the takeover disclosure requirements in Chapter 6 of the Act be incorporated into the scheme provisions in Part 5.1.

142. *Id.* at 50-71 ("Comparing Schemes and Takeovers" and "When Schemes are Used") for detailed discussion.

a. *Advantages of Schemes*

Some of the main advantages of schemes in corporate control transactions are:

- **Certainty**- either the acquirer will get everything they want at the date of the final court hearing, or nothing at all. Situations do exist where achieving 100% ownership is a critical requirement for the bidder. This would occur in circumstances where tax savings and/or cost rationalizations are dependent upon 100% ownership (as opposed to merely majority ownership) of the entity. This is to be contrasted to a takeover bid under Chapter 6 where a bidder could fall far short of the threshold needed for compulsory acquisition (presently 90%).¹⁴³
- **Transparency**- in the way schemes are structured and conducted. This is ensured through court involvement at each step of the scheme process. This can, however, also be seen as a disadvantage from the acquirer's perspective, due primarily to the class voting arrangement and the ability of the court to discount or disregard votes based on extrinsic interests in schemes.¹⁴⁴
- **Structural Flexibility**- schemes can be used to achieve lots of different objectives (e.g., demerger of business units at the same time, buyback and return of franking credits).

b. *Disadvantages/Costs Associated with Schemes*

In the last major policy consideration of takeovers in Australia, the government's CLERP 4 policy paper included a summary of the advantages and disadvantages of schemes in corporate control transactions. According to this paper, "it has been argued that schemes are cumbersome, slow and costly, and may have less flexibility than takeover bids. For example, variations of a scheme require further court approval or even recommencement of the entire approval process. Thus it is extremely difficult for a bidder to increase the price offered under a scheme and this may have "devastating" consequences if a rival bidder

143. In relation to a takeover bid pursuant to Chapter 6, § 661A(1) provides that the bidder may compulsorily acquire any securities in the bid class if *inter alia* they hold, during or at the end of the bid period, a relevant interest in at least 90% (by number) of the securities in the bid class. The provision further provides that the bidder must have acquired at least 75% (by number) of the securities that the bidder offered to acquire under the bid. Corporations Act 2001 § 661A(1) (Austl.).

144. See DAMIAN & RICH, *supra* note 90, at 3.

offers a higher price."¹⁴⁵

Further, in terms of the limited use of schemes in corporate control transactions, the paper notes that, "schemes will only be viable alternatives to takeovers in a limited number of situations. For example, schemes would not be a viable alternative to a hostile or defended takeover bid, as it is the company which must bring the scheme before a court for approval. This will form a 'natural' hurdle to using schemes as an alternative to takeovers."¹⁴⁶

For a detailed account of the strengths and weaknesses of schemes in the context of corporate control transactions, readers are referred to Chapter five of the Damian and Rich monograph discussed above.¹⁴⁷

D. Cleaning Up Takeovers Regulation: Removing the Dual System of Schemes and Chapter 6 Takeovers

I believe that it is well and truly time to cleanse Australian takeovers regulation of the use of schemes. Notwithstanding § 411(17) of the *Corporations Act*, schemes have traditionally been used to bypass Chapter 6, and to achieve certain commercial benefits not considered to be available when proceeding under Chapter 6.

But the scheme regime in Part 5.1 of the *Corporations Act* was never intended to give effect to a takeover. ASIC originally adopted a policy enabling schemes to be used for this purpose to facilitate takeovers of options and managed investment schemes that were outside the scope of Chapter 6. But the law has moved on, and Chapter 6 now specifically captures managed investment schemes (options are still outside Chapter 6, but can be converted to cover securities for the purposes of a friendly corporate control transaction).

While ASIC's policy, expressed now in Policy Statement 60, was questionable to begin with, the retention of this policy now that Chapter 6 has been amended is totally inappropriate. Sure, there are some commercial benefits of using a scheme rather than a formal Chapter 6 bid in particular circumstances, but this does not give ASIC a license to radically alter the design of takeovers law in Australia.

If it is still considered desirable to have available an "arrangement" for giving effect to a change of corporate control as an alternative to a formal takeover bid, I believe this can be facilitated through Chapter 6 itself, rather than a regime outside of Chapter 6 that regulates a device-

145. CLERP 4 Policy Paper, *supra* note 98, at 53.

146. *Id.*

147. DAMIAN & RICH, *supra* note 90, at 82-93 (criticizing schemes).

the scheme of arrangement – which was not designed to deal with corporate control transactions.

Chapter 6 can be used in this way without law reform. That is, it can be used in this way – now. The principal way in which this can be achieved is through an elevated use of § 611(7), a provision which is quite unremarkable in appearance but can have remarkable implications.

E. Section 611(7) as the Mild-Mannered Hero

As noted earlier, § 611(7) is one of the “gateways” in Chapter 6 of the *Corporations Act* to enable a change of corporate control.

Section 611(7)¹⁴⁸ provides that an acquisition of a relevant interest in voting shares that was previously approved by resolution of the target company during a general meeting will be exempt from the general prohibition on corporate control in § 606 so long as:

(a) no votes are cast in favour of the resolution by:

- i. the person proposing to make the acquisition and their associates;¹⁴⁹ or
- ii. the persons (if any) from whom the acquisition is to be made and their associates; (hereinafter referred to as “associated persons”) and

(b) the members of the company were given all information known to the person proposing to make the acquisition or their associates, or known to the company, that was material to the decision on how to vote on the resolution, including:

- i. the identity of the person proposing to make the acquisition and their associates; and
- ii. the maximum extent of the increase in that person’s voting power in the company that would result from the acquisition; and
- iii. the voting power that person would have as a result of the acquisition; and
- iv. the maximum extent of the increase in the voting power of each of that person’s associates that would result from the acquisition; and
- v. the voting power¹⁵⁰ that each of that person’s associates would have as a result of the acquisition.

The significance of § 611(7) operating to enable shareholders to

148. AUSTIN & RAMSAY, *supra* note 54, at 23.290.

Item 7 of § 611 exempts an acquisition approved previously by resolution passed at a general meeting of the company in which the acquisition is made, provided that no votes are cast in favour of the resolution by the acquirer . . . or their respective associates. This enables the general body of shareholders to “opt out” of the statute’s protection.

Id.; AUSTRALIAN ENCYCLOPEDIA OF FORMS AND PRECEDENTS, CORPORATIONS: TAKEOVERS 1050 (Lewis A. Harris ed., Sydney, Butterworths 2d ed.) (1963) (“in order to satisfy the prerequisites of § 611(7), the shareholders of Target must be in a position to make an informed decision on the acquisition and therefore need a full and frank disclosure of all the relevant facts.”).

149. Corporations Act, 2001 § 12 (Austl.) (defining the term “associate”).

150. Corporations Act, 2001, § 611(7) (Austl.).

2006] **Applicability of U.S. Takeovers Laws in Australia** 201

“opt out” of the formalities in Chapter 6 will be explored below.

ASIC’s Policy Statement 74 (titled “Acquisitions Agreed to by Shareholders”) was issued in 1993, in an attempt by ASIC to provide practical guidance about issues pertaining to § 611(7).¹⁵¹ Policy Statements 74.5 and 74.6 deal with the proper and full disclosure the target company must provide shareholders.

[74.5] Section 623 [now § 611(7)] assumes that the directors of a company will provide shareholders with proper and full disclosure to enable them to assess the merits of the proposal, and decide whether to agree by resolution to an acquisition of shares.¹⁵²

[74.6] Directors need to ensure all relevant facts related to the proposal are disclosed but should ensure all matters are disclosed that are material and necessary for the shareholders to make an informed decision on the resolution put to the meeting.¹⁵³

Policy Statement 74.8 also lists the information which case law indicates shareholders are entitled.

[PS 74.8] Current case law indicates that shareholders of a company are entitled, as a minimum, to the following information in the notice of a § 623 resolution or the accompanying explanatory memorandum:

- (a) the identity of the allottee or purchaser and any person who will have a relevant interest in the shares to be allotted or purchased;
- (b) full particulars (including the number and the percentage) of the shares in the company to which the allottee or purchaser is or will be entitled immediately before and after the proposed acquisition;
- (c) the identity, associations (with the allottee, purchaser or vendor, and with any of their associates) and qualifications of any person who it is intended will become a director if shareholders agree to the allotment or purchase;
- (d) a statement of the allottee’s or purchaser’s intentions regarding the future of the company if shareholders agree to the allotment or purchase, and in particular:
 - (i) any intention to change the business of the company;
 - (ii) any intention to inject further capital into the company, and if so how;
 - (iii) the future employment of the present employees of the company;

151. AUSTL. SECURITIES & INVESTMENTS COMM’N, POLICY STATEMENT 74, ACQUISITIONS AGREED TO BY SHAREHOLDERS, (Aug. 12, 1993), available at <http://services.thomson.com.au/asic/ps/ps074.pdf> (last [hereinafter ASIC, Policy Statement 74]).

152. *Id.* at 74.5.

153. *Id.* at 74.6.

- (iv) any proposal whereby any property will be transferred between the company and the allottee, vendor or purchaser or any person associated with any of them; and
- (v) any intention to otherwise redepoly the fixed assets of the company;
- (e) particulars of the terms of the proposed allotment or purchase and any other contract or proposed contract between the allottee or purchaser and the company or vendor or any of their associates which is conditional upon, or directly or indirectly dependent on, shareholders' agreement to the allotment or purchase;
- (f) when the allotment is to be made or the purchase is to be completed;
- (g) an explanation of the reasons for any proposed allotment;
- (h) the interests of the directors in the resolution; and
- (i) in the case of a listed company, any additional information that the Listing Rules require to be disclosed.

See *NCSC v Consolidated Gold Mining Areas NL* (1985) 3 ACLC 520; *Devereaux Holdings Pty Ltd v Pelsart Resources NL* (1985) 9 ACLR 880; *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 7 ACLC 81; *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1988) 6 ACLC 913; and § 731(a) and (c) of the Law.¹⁵⁴

Policy Statement 74.9 goes on to state that it is ASIC's position that shareholders of the target company should be provided with the following information (by the target company or by the acquiring company):

[PS 74.9] Shareholders of a company should also be provided with:

- (a) the identity of the directors who approved or voted against the proposal to put the resolution to shareholders and the relevant information memorandum;
- (b) the recommendation or otherwise of each director as to whether non-associated shareholders should agree to the acquisition, and the reasons for that recommendation or otherwise;
- (c) any intention of the acquirer to change significantly the financial or dividend policies of the company; and
- (d) an analysis of whether the proposal is fair and reasonable when considered in the context of the interests of, the shareholders other than those involved in the proposed allotment or purchase or

154. *Id.* at 74.8.

2006] **Applicability of U.S. Takeovers Laws in Australia** 203

associated with such persons ("non-associated shareholders") (see ¶¶ 11-31).¹⁵⁵

Policy Statement 74 also comprehensively deals with the issues arising from the acquiring company negotiating an agreement prior to the resolution being put to the target company's shareholders in accordance with § 611(7). ASIC is prepared to modify § 611(7) where necessary in order to remove doubt that the terms of the proposed contract or agreement may be discussed and agreed upon subject to certain conditions.¹⁵⁶ This is because the wording of § 608(8) of the *Corporations Act* leaves it open to doubt that such an in-principle agreement would give rise to an "accelerated relevant interest."¹⁵⁷

ASIC's main Policy Statement on takeovers, Policy Statement 171, also provides some information on how ASIC intends to administer § 611(7). The relevant parts are PS [171.54] and [171.56], extracted below:

PS [171.54]: We may give case-by-case relief for an acquisition approved by a resolution passed at a general meeting of the company under item 7 of § 611. This relief would be from the requirement to give all information known to an associate of the person proposing to acquire in item 7(b). The acquirer must show that they have requested information from their associate, but cannot reasonably obtain it.¹⁵⁸

PS [171.56]: An acquisition approved previously by a resolution passed at a general meeting of the company in which the acquisition is made is exempt from the prohibition in § 606: item 7 of § 611. For the exemption to apply, the members of the company must be given all information known to the acquirer or their associates that was material to the decision on how to vote on the resolution: item 7(b).¹⁵⁹

Ford's, in a statement quoted earlier, notes that § 611(7) can be

155. *Id.* at 74.9.

156. *Id.* at 74.47.

157. ASIC, Policy Statement 74, *supra* note 137, at 74.44. The Policy Statement further provides that such doubt would exist, even if "the sale would only be executed, or the power to vote would only be given, once the proposed agreement has been agreed to by non-associated shareholders." *Id.* In Policy Statement 74, ASIC also states that it wishes to administer the law so as to give effect to what it sees as the implied limitation of § 608(8), to promote the practical operation of § 611(7) in order to give effect to "its purpose of promoting business efficiency and certainty, and [to protect] the interests of minority shareholders." *Id.* at 74.46.

158. AUSTL. SECURITIES & INVESTMENTS COMM'N, POLICY STATEMENT 171, ACQUISITIONS AGREED TO BY SHAREHOLDERS, (June 6, 2004), at 171.54 available at <http://services.thomson.com.au/asic/ps/ps074.pdf> (last visited Nov. 29, 2006) [hereinafter ASIC, Policy Statement 171].

159. *Id.* at 171.56.

used so that the target company shareholders can "opt out" of the formalities of a Chapter 6 bid. This provides for the kind of flexibility and efficiency in takeovers regulation that "law and economics" commentators advocate. Rigid, complex, burdensome regulation operates to distort the market for corporate control, which works to effectively price control so that it is allocated to whom ever values that control most.

But what we can see as a major limitation with § 611(17) is that only non-associated shareholders, those whose shares aren't being acquired or who are not the acquirers, can vote. Section 611(7) would have much greater impact if associated shareholders could also vote. Section 611(7) would also be more significant if it could be used for hostile takeovers- enabling the acquiring company to put the resolution to target company shareholders.

As will be explained in the next section, there are mechanisms in place in the *Corporations Act* to enable this to happen. There are also examples where § 611(7) has been used in this way (at this stage, to enable associated shareholders to vote).

It is argued in the next section that § 611(7) should be utilized more regularly to promote a flexible and efficient system of takeovers regulation. The discussion of the economic analysis of law, and utility of limited regulation in the market for corporate control, highlights the importance of promoting this approach to takeovers regulation.

Further, a § 611(7) arrangement can provide for all the commercial benefits of a scheme of arrangement but without the costs associated with schemes. It is therefore time for § 611(7) to be marketed effectively.

III. MARKETING THE PRODUCT OF TAKEOVERS LAW

There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction.

Our problems are man-made, therefore they may be solved by man. And man can be as big as he wants. No problem of human destiny is beyond human beings.¹⁶⁰

- John F. Kennedy

160. The Quotations Page, Quotations by Author - John F. Kennedy, http://www.quotationspage.com/quotes/John_F_Kennedy/ (last visited Nov. 30, 2006).

A. *The Genius of ASIC's Exemption and Modification Power*

It was explained in the last section that takeovers regulation in Australia could be made more flexible and efficient through directing our attention to § 611(7) of the Act. Section 611(7) has enormous potential. It can provide for a self-contained code, in the form of Chapter 6, for the regulation of takeovers, rather than the present dual regulatory structure of formal Chapter 6 bids and schemes of arrangement, located outside of Chapter 6.

This elevation of § 611(7) can be achieved without law reform. It was explained that the mechanism to achieve this flexibility and efficiency already exists in the *Corporations Act*. Instead, what is required is fresh thinking about, and effective marketing of, takeovers regulation in Australia. The market for corporate control needs to be given greater recognition, and the assumption that formal rules are the optimal method of improving regulation needs to put into the dustbin.

But what is this "mechanism" that can generate greater flexibility and efficiency? Section 611(7) is expressly limited in its operation so that only non-associated shareholders can vote on a resolution. So how can § 611(7) step up to the task?

Further, even if § 611(7) is capable of stepping up to improve the efficiency of takeovers regulation, is this desirable? While the regulatory hurdles to a takeover may be lowered, what about the existing protections in place to look after vulnerable shareholders? Are these protections part of the detailed rules that will be washed away with the tide of regulatory reform?

This section deals with these questions. In doing so, it is apt that we again turn to Chapter 6 of the *Corporations Act*, and in particular ASIC's so-called "dispensation power," contained in § 655A of the Act. To begin with, some background on the dispensation power is useful.

1. *Overview of ASIC's Dispensation Power*¹⁶¹

The power of the corporate regulator ASIC to provide relief is said to originally derive from the *Companies (Acquisition of Shares) Act 1980* (Cth) ("Code"), as one of a number of important developments in the regulation of takeovers law in Australia. The regulator at the time, the National Companies and Securities Commission (NCSC) was

161. Background derived from James McConvill & Mirko Bagaric, *Opting Out of Shareholder Governance Rights: A New Perspective on Contractual Freedom in Australian Corporate Law*, 3 DEPAUL BUS & COMM. L.J. 255 (2005). See also LEVY, *supra* note 102, at 233-35.

provided with this discretion to grant relief from the provisions of the Code as it was readily acknowledged that many provisions in the Code were quite complex and volatile, and strict application of the provisions could produce unintended and undesirable consequences. Furthermore, it was considered impossible to construct a black-letter takeovers law which would cover all the unforeseen circumstances which arise from takeover activity, and again ASIC's dispensation powers were considered important here in providing for flexibility in takeovers regulation.

Before the adoption of the Code, there was some suggestion that Australia should adopt a "general principles" approach to national takeovers regulation like in the United Kingdom, rather than a "black letter law" approach like in the United States. It was ultimately settled that a "black letter law" approach was preferable, but only on the basis that the new regulator, the NCSC, would have discretionary power to grant relief from the operation of the takeover provisions. In one of the first evaluations of the 1980 Code and its provisions, Quentin Digby wrote that:

The enactment of the Companies (Acquisition of Shares) Act 1980 heralded an important development in the regulation of corporate takeovers in Australia. The National Companies and Securities Commission (the NCSC), which under the legislation became the body primarily responsible for administering the Takeover Code, was given an unprecedented level of discretionary power. The principal discretions accorded to the NCSC empowered the Commission to extend or reduce the coverage and effect of the Code in its application to particular instances of takeover conduct.

... The 1980 Takeover Code represents a unique regulatory mix. As had been the case with earlier codes, the law was spelt out in a detailed "black letter" form. However, to introduce flexibility and to enable enforcement of the "spirit" of the Code, wide discretions were vested in the NCSC to modify the effect and coverage of the law.¹⁶²

Quentin Digby went on to explain that the dispensation powers given to the NCSC in the Code ensured that there was a "commercially realistic approach" to the operation of the Code.¹⁶³

In the High Court of Australia's decision of *ASIC v DB Management Pty Ltd and Others; Southcorp Wines Pty Ltd v DB*

162. See Quentin Digby, *The Principle Discretionary Powers of the National Companies and Securities Commission Under the Takeovers Code*, 3 CO. & SEC. L.J. 216, 217 (1984).

163. *Id.*

Management Pty Ltd and Others,¹⁶⁴ a useful discussion on the origins and rationale of ASIC's dispensation power was also provided.¹⁶⁵ The Explanatory Memorandum to the Financial Services Reform Amendment Bill 2003 (Cth) also included an explanation of the origins and rationale of ASIC's dispensation powers.¹⁶⁶

Since this relief power was first introduced . . . it has over time been extended to apply to many other areas of Australia's corporations law. A similar power was considered necessary when a complicated regime facilitating share buy-backs was introduced later in the 1980's (although does not operate under the present buy-back provisions in the Act which have been significantly rationalized), and has since also been utilized to provide for commercial flexibility in relation to the financial reporting provisions (except the removal of auditors under Section 329) in Part 2M, the fundraising provisions (Chapter 6D),

164. (2007) 33 A.C.S.R. 447.

165. *Id.* at 464. According to the Court: Section 57 and 58 of CASA [the Companies (Acquisition of Shares) Act 1980] contained provisions corresponding to Sections 728 and 730 of the Law. Section 57 empowered the NCSC to exempt a person from compliance with all or any of the requirements of the Code. Section 58 empowered the NCSC to declare that the Code should have effect in its application to or in relation to a particular person or persons in a particular case as if a provision or provisions of the Code was or were omitted or varied or modified as specified, and 'where such a declaration is made, the Code has effect accordingly.

This represented a legislative response to a problem of policy concerning regulation of takeovers. It involved a compromise between the technique of general legislative prescription applying inflexibility to all cases, and that of administrative discretion addressing issues on a case by case basis. The NCSC was given power, not merely to determine that, in certain cases, the legislative scheme would not apply, but also to modify or vary the operation of the scheme. . . . It created a new set of rights and obligations.

Id.

166. Financial Services Reform Amendment Bill 2003, Supplementary Explanatory Memorandum, § 3.58-3.59 (Austl.)

ASIC uses its exemption and modification powers to provide administrative relief from the operation of various provisions of the legislation in circumstances where it judges that application of those provisions is not warranted, or that they should apply in a modified way. In most situations, the exemption and modification powers are exercised in response to requests for relief from parties who are experiencing difficulties complying with a particular provision of the legislation or where the application of the provisions is not appropriate in particular circumstances.

Depending on the circumstances, the strict operation of the legislation may produce unintended or unreasonable results. Moreover, exemptions and modifications will often be necessary to facilitate innovative products that were not contemplated at the time the legislation was drafted, while maintaining an appropriate degree of investor protection.

provisions regulating managed investment schemes (Chapter 5C) and, most recently, was incorporated as a very important component of the financial services regime under Chapter 7 of the *Corporations Act*.¹⁶⁷

The manner in which ASIC handles application for relief from the *Corporations Act* using its dispensation powers (including § 655A which provides for relief from the provisions of Chapter 6)¹⁶⁸ is set out in its Policy Statement 51.¹⁶⁹

In my view, what is particularly significant about Policy Statement 51 is that ASIC, whether knowing it or not, adopts a standard economic view of corporate regulation through employing a cost-benefit analysis

167. McConvill & Bargaric, *supra* note 161.

Although over time the reach of the ASIC's relief powers has extended to apply to most substantive provisions under the *Corporations Act*, what is very interesting is that the powers do not apply to provisions in the Act containing important participatory rights for shareholders, such as § 203D and the 100 member rule in § 249D(1). This has not been an accidental omission. When one looks at the *Corporations Act* in its entirety, it is quite clear that the exclusion of the ASIC's powers of relief from these provisions is quite deliberate. For example, the ASIC is given the power to exclude or modify the operation of particular provisions of Part 2M of the Act regulating financial reporting, however specifically excluded from this power is the provision stating that the removal of a company's auditor(s) is to be approved by an ordinary meeting of shareholders. Moreover, the various rights of shareholders in relation to company meetings under Part 2G.2 (e.g., the power of 100 shareholders to requisition a shareholder meeting under § 249D(1) can be modified, but only by the passage of Regulations under the Act, not by ASIC.

Id.

168. Section 655A of the *Corporations Act* provides that:

(1) ASIC may:

(a) exempt a person from a provision of this Chapter; or

(b) declare that this Chapter applies to a person as if specified provisions were omitted, modified or varied as specified in the declaration.

Note: Under section 656A, the Panel has power to review the exercise by ASIC of its powers under this section.

(2) In deciding whether to give the exemption or declaration, ASIC must consider the purposes of this Chapter set out in section 602.

(3) The exemption or declaration may:

(a) apply to all or specified provisions of this Chapter; and

(b) apply to all persons, specified persons, or a specified class of persons; and

(c) relate to all securities, specified securities or a specified class of securities; and

(d) relate to any other matter generally or as specified.

Corporations Act, 2001, § 655A (Austl.). Under section 656A, the Panel has the power to review the exercise by ASIC of its powers under this section. *Corporations Act*, 2001, § 656A (Austl.).

169. See James McConvill, *Removal of Directors Takes Centre Stage in Australia: An Exploration of the Corporate Law and Governance Issues*, 1 CORP. GOVERNANCE L. REV. 191, 235-36 (2005) (discussing the operation of ASIC's Policy Statement 51 in relation to applications for relief).

2006] **Applicability of U.S. Takeovers Laws in Australia** 209

to determine whether it is appropriate or not for relief from the Corporations Act to be granted (in the form of modification or an exemption) in each particular instance.

Applications for relief involve ASIC weighing up the regulatory burden and commercial benefit resulting from the proposed relief being granted. Policy Statement 51 provides that ASIC will grant relief where:

- (a) it considers that there is a net regulatory benefit; or
- (b) the regulatory detriment is minimal and is clearly outweighed by the resulting commercial benefit.¹⁷⁰

According to *Ford's Principles of Corporations Law*, ASIC's dispensation power and policy statements comprise an "essential supplement" to the "black letter" of the *Corporations Act*, *Corporations Regulations*, and case law, particularly in the area of fundraising and takeovers.¹⁷¹ Although commentary and material is available to explain how ASIC's power operates, I was quite surprised to find little in the way of detailed exploration of the rationale for having a relief power vested in ASIC, the desirability of the power from both a normative and practical perspective, why the relief power only applies to specific provisions of the *Corporations Act* rather than having a broad-ranging power which applies to all the provisions of the Act, and whether a more expansive relief power should be something to be considered.

Due to the complexities and compliance costs associated with the financial reporting, fundraising and takeover provisions of the Act, I understand why ASIC has been given a power to grant modifications and exemptions for applicants in relation to these provisions, and it also explains why applications for takeovers and fundraising relief also forms a significant component of ASIC's work. It is quite clear that on many occasions the regulatory detriment of granting relief is minimal and is clearly outweighed by the commercial benefit of companies not being faced with the commercial burden of having to comply with the provision.¹⁷²

170. ASIC, Policy Statement 51, PS 51.44 (Sept. 14, 2006), available at <http://services.thomson.com.au/asic/ps/ps051.pdf> (last visited Nov. 29, 2006).

171. *Id.* at 51.3 (the "discretionary [power]" of the [Act] which are "most frequently [exercised]" affect the provisions in the Law concerning accounts, takeovers, and prospectuses); AUSTIN & RAMSAY, *supra* note 54, at 3.141 (showing that in 2000-01, ASIC considered 320 equity fundraising relief applications, and 638 takeover relief applications).

172. Corporations Act, 2001, § 661A. One example is relief from § 661(A) which essentially provides that . . . if a party "and their associates have relevant interest in at least 90% . . . of the securities in a company," they can acquire the remaining shares for fair

2. Dispensation Power as a Mechanism for Contractual Freedom

In Part II, it was explained that central to the economic analysis of law is the idea that the corporation is a “nexus of contracts” and that corporate law provisions should operate as a set of “default rules” that corporations can abide by or “opt out” of depending on whether the affairs of the corporation can be more efficiently organized outside of the formal regulatory regime.¹⁷³

The role of the law, therefore, is to mimic the market (for corporate control or something else) as much as possible, so that the law becomes an attractive product when the transaction costs of operating outside of the formal regulatory regime become substantial.

While economic thinking is central to the theory and practice of corporate law in the U.S., it has not assumed a significant role in relation to corporate law in Australia.¹⁷⁴ But the interesting thing is that while “law and economics” rarely forms part of the literature or discussion on corporate law in Australia, corporate law – including the law regulating takeovers – is structured so that, with some attention, it can align itself quite easily with the “contractarian” model of regulation promoted by adherents to an economic analysis of corporate law.¹⁷⁵

A prime example of this is ASIC’s dispensation power discussed above. This power provides an avenue for corporations to “opt out” of formal legal rules- including the provisions in Chapter 6 which regulate takeovers. While the dispensation power has not been considered to be a mechanism to “opt out” of corporate law, and accommodate “contractual freedom” in U.S. law and economic sense, it should be.¹⁷⁶

Undoubtedly the main reason why dispensation powers of ASIC has not been seriously considered as a formal mechanism facilitating opting out of corporate law is the company and its shareholders do not have complete freedom to decide whether or not to opt out of a relevant provision. Rather, relief is dependent on ASIC providing consent.¹⁷⁷

With this particular distinction in mind, “is it therefore appropriate to classify ASIC’s relief powers as a formal mechanism in the Act

value. See e.g. Australian Securities and Investments Commission v. DB Management Pty Ltd, (2000) 199 C.L.R. 321(Austl.). Note also that under § 661(A)(3), a court also has the power to change the 90% threshold. Corporations Act 2001 § 661(A)(3) (Austl.).

173. McConvill & Bagaric, *supra* note 161, at 270-71.

174. *Id.* at 256.

175. *Id.*

176. *Id.* at 269.

177. *Id.* at 284-85.

facilitating opt out arrangements?"¹⁷⁸

A very important point to note here is that out of all the articles and books from a number of different countries that I have read, there is next to no reference to dispensation powers of corporate or securities regulators as being formal mechanisms facilitating opting out. The only discussion of the role of public regulators in the context of opting out of corporate law was in passing, with no real acknowledgment of the importance of this role.¹⁷⁹

While many countries do not have a corporate regulator similar to the ASIC, or a corporate regulator vested with the dispensation powers that the ASIC enjoys, many countries do – so surely there has to be a reason why such an important aspect of corporate law has previously not been given serious consideration when discussing opt out arrangements.

In my opinion, undoubtedly the main reason why dispensation powers of corporate regulators have not been seriously considered as formal mechanisms facilitating opting out of corporate law is the company and its shareholders do not have complete freedom to decide whether or not to opt out of a relevant provision(s). Thus, on this view, attaching a dispensation power to a particular provision does not alter the mandatory nature of the provision – companies are required to comply with the provision unless and until the regulator decides to provide relief. In other words, the ultimate discretion as to whether or not a company will comply or opt out of a provision is not with the company, but with the regulator.

Accordingly, continuing this argument, there is a fundamental gulf between traditional private ordering or ‘contracting out’ of a corporate law rule by obtaining the approval of shareholders within the corporation, and the operation of a dispensation power by the public regulator outside of the corporation. The former involves literally opting out of a corporate law rule, the latter does not involve opting out of corporate law, but instead entails an alternative form of corporate law rule – abide by the procedure of obtaining approval by the regulator to be relieved from complying with a specific obligation or procedure in the Act. Put simply, opting out of corporate law must be a strictly private affair. Once there is the “public” involvement of the regulator,

178. McConvill & Bagaric, *supra* note 161, at 284.

179. See John C. Coffee Jr., *No Exit? Opting Out, The Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOK. L. REV. 919 (1988); Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1851 (1989).

the arrangement cannot be described as “opting out” but rather compliance with an alternative form of corporate law rule.

In my opinion, however, this is a rather specious argument to run. One can never truly escape corporate regulation, even if the purpose of an arrangement or legislative initiative is to “avoid” corporate law rules. To be able to avoid or limit the application of a corporate law rule to a particular entity, person or circumstance itself requires some form of consenting action for this – either through the enactment or adoption of a legislative or executive rule authorizing this, or judicial endorsement of a particular arrangement (e.g., ratification by shareholders of a transaction in breach of a director’s duty to avoid conflicts of interest).

Accordingly, just like an individual’s “freedom” in society does not provide a license to kill a person or steal from others, contractual “freedom” in corporate law does not exist in a pure form. Freedom is necessarily shaped by “boundaries.” Contractual freedom in corporate law is embraced to provide for flexibility tempered by efficiency, and its reach therefore cannot extend to any opting out arrangements when many of these default arrangements would be inefficient. Professor John Coffee once wrote, in an important contribution on the judicial role in opting out of corporate law, that the courts in the U.S. have developed “standards” which companies endeavoring to opt out of particular corporate law rules need to work within to prevent their default arrangements being struck down by the court if challenged. This constructs a boundary around the freedom that companies have to opt out of particular corporate law rules that are enabling in nature.¹⁸⁰

In his article, Coffee considers the cases where courts have been confronted with attempts to contract out of corporate law, and attempts to understand how courts might and should respond to innovative departures from the “traditional norms of corporate governance.” The

180. See John C. Coffee, *Contractual Freedom in Corporate Law-The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role*, 89 COLUM. L. REV. 1618, 1690 (1989):

If the new breed of lawyer-economists is to be listened to by courts, they must, in turn, listen to how courts think. How then do courts think about contractual freedom and opting out? Clearly, they do not view statutory corporate law as simply a body of default rules, which shareholders may waive at will. Rather, courts exercise substantial discretion to accept or reject a contractual innovation, depending upon whether they attribute a “fat” or a “thin” policy to the statutory norm asserted to be in conflict with the charter provision. As a statute begins to seem obsolete or superfluous, courts have recurrently shown a willingness to shrink their conception of its underlying policy, but only on a few occasions have courts converted a mandatory norm into a default rule.

Id.

article also focuses on the process of statutory interpretation and asks when, if ever, courts should make new mandatory rules or change old default rules. In reviewing the cases, Coffee explains that it can be seen that the courts develop standards for opting out so that shareholders are not able to opt out at will- and makes it clear that it cannot therefore be said that there is complete "contractual freedom." One example Coffee provides to support his contention is judicial decisions indicating that the courts prefer transaction-specific modifications or exemptions from fiduciary duties as opposed to ongoing relief. Furthermore, opting out of fiduciary duties has always been subject to the limitation that directors continue to meet a standard of good faith in their commercial behavior.

In light of the above, I believe that there is no conceptual barrier to labeling dispensation powers of a corporate regulator, as a formal mechanism to 'opt out' of corporate law rules. There is no major difference between a private arrangement between the company and its shareholders or some other stakeholder which is subject to court challenge if constructed in a manner operating outside the realm of traditional norms of corporate governance (e.g. allowing commercial behavior by directors which does not comply with standards of good faith), and the power of a corporate regulator to grant an exception or modification to a particular company from the operation of a corporate law rule.

Both mechanisms are subject to supervision, explicitly or implicitly, by a public body- placing limits on the discretion of the company; both mechanisms allow for the avoidance of a corporate law rule(s) in particular circumstances; both mechanisms are designed to ultimately accommodate a greater sense of flexibility and efficiency in corporate regulation (including the regulation of takeovers); and both mechanisms are themselves constructed by a corporate law rule and thus ultimately operate inside rather than outside the realm of corporate law. Accordingly, if there is a general consensus that traditional private arrangements, or "private ordering", can be said to constitute "opting out" of corporate law, then surely it can convincingly be said that the utilization of dispensation powers by a corporate regulator provides for "opting out" of corporate law.¹⁸¹

181. See McConvill, *supra* note 114 (including an extensive discussion of ASIC's discretionary powers and the appropriateness of relating them to literature on "opt in/opt out"). The article also includes a proposal to extend ASIC's modification and exemption powers to remove directors. See *id.*

B. *Appreciating Real Genius: Section 611(7)*

1. *The Marketing of § 611(7)*

Section 655A provides for relief from Chapter 6 provisions, including § 611(7). It has been pointed out above that a modification of § 611(7) in corporate control transactions is possible to enable interested shareholders to vote and/or to enable the potential acquiring company to put a resolution to target company shareholders. In this sense, § 611(7) seems to fit within what Bebchuk and Hamdani have described as a "reversible default."¹⁸²

If § 611(7) is used in this way, it provides a mechanism to bypass the formalities of Chapter 6 unless a formal Chapter 6 bid is considered to be in the best interests of all concerned. Modification of § 611(7) to facilitate this, requiring a simple application to ASIC rather than legislative reform, simplifies takeovers regulation and makes regulation more efficient.

This relationship between § 611(7) and § 655A needs to be better marketed. Section 611(7) should be promoted as a device which can be utilized to inject greater flexibility into takeovers regulation. Section 611(7) can achieve the flexibility and efficiency that is considered to be lacking in Australian takeovers regulation. The task is to sell it this way.

Section 611(7) can make the market for corporate control in Australia more attractive. The distortion caused by a complex and burdensome takeovers code being imposed in a relatively small market can be corrected through putting forward § 611(7) as a mechanism by which parties can be provided with greater freedom in how a particular control transaction is to be regulated.

Importantly, there is a precedent for § 655A being utilized to modify § 611(7) so that it has a wider scope. While, from my research, there has yet to be a clear example of § 611(7) being used in the context of a hostile takeover, there are a number of examples of ASIC granting relief from § 611(7) so that interested shareholders could vote.

Therefore, it is far from radical to suggest that ASIC can play a part in injecting flexibility and efficiency into the regulation of takeovers in Australia. It is already doing so, albeit in a rather modest way.

182. Lucian Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 NW. U. L. REV. 489, 493-95 (2002). A "reversible default" starts as a rule restrictive to management, and provides shareholders with the opportunity to "opt out." *Id.*

While more applications for medication of § 611(7) could consume the resources of ASIC, ASIC does charge a fee for each relief application.¹⁸³ Accordingly, ASIC would generate funds from the extra applications that could be allocated to pay for an increase in professional and administrative staff as this was necessary to handle any extra workload.

Importantly, viewing § 611(7) through an economic, “contractarian” lens not only provides for flexibility in the operation of the Chapter 6 code, but also opens up the possibility of Chapter 6 operating as a self-contained mechanism for regulating corporate control transactions in Australia. I have already said that schemes of arrangement should not apply to control transactions which come under the jurisdiction of Chapter 6. Section 611(7) provides a way to end the dual system of schemes and Chapter 6 bids once and for all.

At the end of the day, the transaction put to a shareholder vote under § 611(7) is an “arrangement”, an “arrangement” that covers a host of situations by which corporate control is transferred from one party to another. Why then do we need a separate regime in the form of Part 5.1, operating outside of Chapter 6, to deal with arrangements impacting on corporate control?

The simple answer is, if § 611(7) is capable of being modified by ASIC to have a broad operation, we do not.

Furthermore, I believe that the application of § 611(7) is far more desirable than the regime regulating schemes of arrangement. All of the commercial advantages explaining why schemes have been used for corporate control transactions (certainty, transparency, structural flexibility etc), can be obtained by using § 611(7) to effect control transactions. At the same time, all the disadvantages recognized in using schemes (stemming mainly from the involvement at the court at each stage, which leads to cost and time issues, but also the fact that the scheme is an “all or nothing” chance for the acquiring company) can be avoided.

Subject to the need to satisfy ASIC that shareholders are sufficiently informed of the proposed acquisition, and that their rights will not be abused, a resolution put to shareholders under § 611(7) can be structured in whatever way the parties want, to achieve whatever arrangement the parties desire. If it is 100% control the acquiring company wants, this can be specified in the arrangement put to

183. See ASIC, Practice Note 58 (Jan. 13, 2006), *How ASIC charges fees for relief applications*, available at <http://services.thomson.com.au/asic/pn/pno58.pdf> (last visited Nov. 30, 2006).

shareholders for a vote. If a particular commercial or tax advantage is sought through an acquisition, the arrangement can be structured to achieve this outcome. If it is felt that certain shareholders should vote separately on the transaction during to having a distinct interest in the transaction which differs to other shareholders, the arrangement can be designed so that shareholders vote in separate classes.

Whereas a court overseeing a scheme under Part 5.1 tries to ensure that shareholders are treated in a fair and reasonable manner, with a § 611(7) arrangement, the Takeovers Panel will continue to have jurisdiction to make a declaration of "unacceptable circumstances", under § 657D, if shareholders are ill-treated. As was discussed in Section three, a declaration of unacceptable circumstances can be made if the particular transaction fails to satisfy one or more of the principles in § 602. Whereas a court can refuse to approve a scheme, the Takeovers Panel can make orders having the effect that the takeover either doesn't proceed, or doesn't proceed in the manner intended.

2. Section 611(7) as a "Choice-Enhancing Mechanism"

Investor confidence is a crucial feature of efficient financial markets. It facilitates attracting the capital necessary for ensuring the liquidity required for an efficient capital market. A higher market turnover provides a more effective price mechanism as a result of the increased information available from increased transaction volume. Investor protection is a significant element contributing to market confidence. People will be less likely to invest directly in the capital market if they perceive that they are likely to receive lower returns because of insufficient information or a weak bargaining position.¹⁸⁴

As a "choice-enhancing mechanism,"¹⁸⁵ which also has built in the

184. Australian Department of Treasury, *Policy Framework*, available at <http://www.treasury.gov.au/documents/267/HTML/docshell.asp?URL=index.asp> (last visited Nov. 30, 2006).

185. See Lucian Bebchuk & Allen Ferrell, *A New Approach to Takeover Law and Regulatory Competition*, 87 VA. L. REV. 111. According to Bebchuk and Ferrell, more choice rather than less choice in relation to takeovers regulation is to be favored. They further argue for "choice enhancement" through two initiatives: (1) the development of a federal law regulating takeovers in the U.S.; and (2) the introduction of a "procedural rule" permitting unilateral action on the part of a majority of shareholders to reincorporate into the federal takeovers law regime. See *id.* See also Lucian Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk? Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553 (2002) (explaining "choice enhancing"); Stephen Choi and Andrew Guzman, *Choices and Federal Intervention in Corporate Law*, 87 VA. L. REV. 961, 981 (2001) ("The procedural rule advocated by Bebchuk and Ferrell consists of a mandatory voting procedure through which a majority of shareholders . . . can choose federal takeover rules rather than those of the State in which the corporation is incorporated. Shareholders

regulatory protections of the antiquated scheme regime but without the costly inefficiencies, § 611(7) is more in line with how shareholders would hypothetically bargain for their takeovers regulation, and therefore is a more desirable form of regulation.

Based on economic theory, investors are more inclined to bargain for a form of regulation which is less costly and more efficient. According to Brian Cheffins in his excellent work *Company Law: Theory, Structure and Operation*, regulation should be shaped through hypothetical bargaining, which involves "thinking about what rational transactors would contract for if they had perfect information, did not face significant transaction costs, and could be fully confident that the agreements reached would be performed as arranged."¹⁸⁶

According to a Nobel Prize winning theory developed by the University of Chicago's Ronald Coase, in the absence of transaction costs, which distort the effective operation of a particular market, regulation shifts towards its most efficient use.¹⁸⁷ In *The Encyclopaedia of Law and Economics*, Medema and Zerbe Jr., provide the following useful explanation of the so-called "Coase Theorem."

Coase argued that, "from an economic perspective, the goal of the legal system should be to establish a pattern of rights such that economic efficiency is attained."¹⁸⁸

can vote in a similar way to exit the federal scheme and return to state. These votes would be binding on the corporation.").

In the context of takeovers and shareholder empowerment, Lucian Bebchuk has also put forward the idea of "undistorted shareholder choice," by making it necessary for hostile bidders to win a vote of shareholder support. See Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. Chi. L. Rev. 973, 982 (2002) ("A voting mechanism provides a 'clean' way of enabling shareholders to express separately their preferences [in relation to whether a takeover should go ahead, and whether they want their shares acquired under the takeover]."). See also Lucian Bebchuk, *Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1697-98 (1985) ("According to the undistorted choice objective, a target should be acquired if and only if its shareholders, or at least shareholders holding a majority of its shares, judge the offer acquisition price to be higher than the independent target's value.").

186. BRIAN CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE AND OPERATION* 264 (Oxford University Press 1997).

187. See Ronald H. Coase, *The Problem of Social Costs*, 3 J.L. & ECON. 1 (1960); available at

<http://www.law.uchicago.edu/socrates/coase.html> (last visited Nov. 30, 2006) (discussing the Coase Theorem: "in a world where there are no transaction costs, an efficient outcome will occur regardless of the initial allocation of property rights.").

188. STEVEN G. MEDEMA & RICHARD O. ZERBE JR., *The Coase Theorem*, in *THE ENCYCLOPAEDIA OF LAW AND ECONOMICS* 836 (Gerrit de Geest & Boudewijn Bouckaert, eds. 2000).

There are two general claims about outcomes which represent the Coase Theorem.

The first is that, regardless of how rights are initially assigned, the resulting allocation of resources will be efficient. This proposition – the “efficiency hypothesis” – is reflected in all statements of the Theorem. The second claim, which is not reflected in all statements of the Theorem, is that the final allocation of resources will be invariant under alternative assignment of rights.¹⁸⁹

Coase believed that government’s role is to eliminate or at least reduce transaction costs, where these are present, through the use of regulation. Transaction cost economics is all about what kinds of initiatives (such as firms or markets) will minimize the transaction costs of producing and distributing a particular good or service.¹⁹⁰

When transaction costs – that is, the costs involved in an economic exchange – are present, as they are in the market for corporate control, the most effective approach to regulation is to try and reduce the transaction costs so that the market is more efficient. But at the same time, an unfettered market is not desirable if lack of investor confidence due to poor protection hampers efficiency.

The elevation of § 611(7), in the manner outlined above, is designed to provide an option to choose an approach to the regulation of a takeover which reduces transaction costs involved in the alternative options of schemes of arrangement or a full-scale Chapter 6 takeover bid, but still imbedding the protections of these regimes. As a product in the market for corporate control, fresh thinking about § 611(7) makes takeovers regulation more attractive, and sets in place a product strategy which should have the effect of increasing consumer demand for the

189. *Id.* at 838. Medema and Zerbe Jnr. provide an explanation of the Coase Theorem from a non-cooperative game perspective:

The initial assignment of rights establishes the utility level of each player in the absence of further reallocations of resources and there are assumed to exist reallocations of resources which are efficiency enhancing, in the sense that the utility of one player can be increased without reducing the utility of the other player. However, neither party will agree to an alteration in the allocation of resources unless that reallocation increases its utility.

Id. at 852.

190. See Wikipedia, *Coase Theorem*, http://en.wikipedia.org/wiki/Coase_theorem (last visited Nov. 30, 2006)

[T]he theorem states that in the absence of transaction costs, all government allocations of property are equally efficient, because interested parties will bargain privately to correct any externality. As a corollary, this theorem also implies that in the presence of transaction costs, government may minimize inefficiency by allocating property initially to the party assigning it the greatest utility.

Id.

product.

It is for this reason that the ideas outlined in this article should be given serious attention going forward.

CONCLUSION

The market for corporate control has been recognized as one of the primary mechanisms operating to ensure that directors and managers remain accountable to shareholders, and that the interests of management and shareholders are aligned.

Takeovers law is a product offered in this market, a product which can be effective in promoting efficiency by way of building investor confidence, but which can be a burden if the law distorts the operation of the market.

The manner in which takeovers law should be structured, and the considerations which should guide its development, has been a major issue since the 1980s.

Takeovers law has been a primary area of focus among commentators interested in the economic analysis of law in general, and corporate law in particular. As has been discussed in this article, economic analysis of takeovers law raises questions about whether mandatory rules have a place at all in the market for corporate control.

While economic analysis of law, including takeovers law, has been prominent in the United States and some European countries, it has yet to be really embraced in Australia.

In this article, I have argued that it is time for this to change. Economic analysis has much to offer. In this article, I have perceived takeovers law as a product in a market, just like a pair of glasses or a candy bar. I suggested that in Australia this product, in its present form, is not being marketed effectively to highlight the genius of the product.

It was explained that Australian takeovers law can facilitate the flexibility and efficiency that economic analysis suggests is central to an effective program of takeovers regulation. This does not require law reform. Rather, it was argued that takeovers law, as a product in the market for corporate control, can be reinvigorated through the application of basic principles of marketing.

A "product management" approach to takeovers law can change in a fundamental way how takeovers are regulated in Australia, without a drop of legislative ink.

The end result of this product management approach is that the dual system of schemes of arrangement and formal Chapter 6 bids, which the market for corporate control in Australia presently endures,

would end.

Contrary to what some commentators have recently proposed, I believe that schemes of arrangement can, and should, be removed from the takeovers regime in Australia through effective marketing of one little-known provision in Chapter 6 of the Corporations Act: § 611(7). This article explained this can be achieved. The challenge now is to put the vision in this article into practice.