

SHOULD THE COMPULSORY ACQUISITION BAR FOR TAKEOVERS BE LOWERED?

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Legal Briefings - By **Rodd Levy**

Is the 90 per cent post-bid compulsory acquisition threshold too high? In this article, we suggest lowering the threshold to 75 per cent in recommended transactions and consider the resulting benefits.

IN BRIEF

- At present, Australian law requires a bidder to reach a 90 per cent ownership stake to proceed to compulsory acquisition.
- Acquiring a 90 per cent stake is usually a difficult task and the current compulsory acquisition threshold deters many acquirers from launching a bid.
- Lowering the compulsory acquisition threshold in a recommended bid to 75 per cent (the same threshold that applies to schemes of arrangement and company constitution amendments), whilst preserving shareholders' ability to prevent compulsory acquisition if the price did not represent 'fair value', would increase market efficiency and benefit the majority of target shareholders and the Australian economy generally.

THE CURRENT POSITION

At present, the law requires a bidder to reach 90 per cent ownership post-takeover bid to proceed to compulsory acquisition. Is this too high?

Reaching 90 per cent is usually a very onerous task and it deters many acquirers from undertaking takeover bids. Downer EDI's recent bid for Spotless is an obvious example of the difficulty of reaching 90 per cent. Despite being endorsed by the Spotless directors and holders of the vast majority of shares in Spotless being happy to sell their shares at the bid price, Downer marginally fell short of the 90 per cent compulsory acquisition threshold (having obtained an 87.8% stake when its offer closed on 29 August 2017), after a New York hedge fund, Coltrane Asset Management (which held approximately 10.5 per cent in Spotless) refused to accept its bid.

If this remains the position, Downer will be frustrated in managing the Spotless businesses and combining them with the existing Downer businesses. This will be to the detriment of value creation and the flow-on benefits to the Australian economy.

The 90 per cent threshold dates from the 1920s. It was introduced as a tentative first step in establishing a policy for compulsory acquisition. Previously, there was no such rule.

AN OPPORTUNITY FOR REFORM

Since then, the pendulum in company regulation has swung in favour of supporting the economic benefits that accrue from company takeovers, which often means the interests of shareholders to retain minority shareholdings have to take second place.

A test requiring the bidder to acquire 75 per cent of the shares of the target company (that is, excluding any shares held before the offer) would be appropriate where independent directors of the target are endorsing the proposal.

That is the same threshold that applies to schemes of arrangement, amendments to a company's constitution and various other corporate actions under the Corporations Act.

In addition, a 75 per cent threshold would enhance the ability of a target company to run a competitive auction for itself even if one bidder had acquired a pre-bid stake of more than 10 per cent in order to deter rival bidders seeking to acquire 100 per cent ownership of the target.

This would also lead to a more efficient market for takeover bids, for the benefit of a majority of shareholders and the wider economy generally.

Lowering the compulsory acquisition threshold would also give additional weight and power to the recommendation of the target company directors.

The target directors typically find themselves in a difficult position if they have rejected a bid but the bidder has received acceptances that have taken it over 50 per cent ownership of the target.

Under the current regime, many directors feel compelled to change their recommendation in those circumstances, given the risks associated with shareholders remaining as minority shareholders in the target.

If the law was changed, target directors would still have the leverage of being able to effectively offer a reduction in the compulsory acquisition threshold, in return for a bid price increase in that situation.

Shareholders would retain the ability to seek a court order preventing compulsory acquisition if they could demonstrate the price to be paid did not represent “fair value”.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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