



Chapter 6A: The new compulsory acquisition regime

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⚙️ **Compulsory acquisitions and buyouts**

⚙️ **Meaning of 'fair value'**

The Corporate Law Economic Reform Program Act 1999 (Cth) ('CLERP Act') inserted Chapter 6A, entitled Compulsory Acquisitions and Buy-Outs, into the Corporations Law, effective 13 March 2000. This chapter redrafts and extends the provisions in the Corporations Law governing the ability of a shareholder with an overwhelming interest in a company to acquire compulsorily outstanding securities. This article reviews the new compulsory acquisition provisions, with particular emphasis on the meaning of 'fair value'. The concept of 'fair value' permeates the new provisions and is likely to attract quite a deal of judicial consideration.

Some history

Before outlining the new provisions, it is helpful to review briefly the compulsory acquisition regime that applied before 13 March 2000. That regime was encompassed principally within former s 701. The new Chapter 6A largely removes the impediments former s 701 created for majority shareholders.

Former s 701 could only apply following a takeover bid. Further, the compulsory acquisition procedure in former s 701 only applied to voting shares, meaning that the old procedure could not be used to acquire compulsorily convertible securities. This limitation was important because if convertible securities were converted during the takeover period or after the takeover period closed, the target was contractually bound to issue shares to the convertible security holders. This issue of new shares to third parties would frustrate the bidder's intention of acquiring and or maintaining absolute control of the target.

ASIC was prepared to grant relief to allow a takeover offer to extend to encompass shares issued during the takeover period due to the conversion of convertible securities. However, ASIC was not prepared to use its modification power to allow a bidder to acquire compulsorily convertible securities that remained after a takeover bid closed.

An overview of the new provisions

The new compulsory acquisition provisions in Chapter 6A are organised into six parts:

Part 6A.1 — Compulsory acquisitions and buy-outs following a takeover bid

This part re-drafts and extends former s 701.

Part 6A.2 — General compulsory acquisitions and buy-outs

This part is especially significant, as it introduces a new compulsory acquisition power that may be invoked without the need for an immediately preceding takeover bid to have been made.

Part 6A.3 — Completion of compulsory acquisition of securities

This part sets out the procedural mechanics and timeframes for completing an acquisition of securities permitted under Part 6A.1 or Part 6A.2. Part 6A.3 will not be discussed further.

Part 6A.4 — Experts' reports and valuations

This part requires a party seeking to acquire securities compulsorily under Part 6A.1 or Part 6A.2 to obtain an expert's written opinion on whether the proposed acquisition terms give a 'fair value' for the relevant securities.

Guidelines are provided for determining fair value, with provisions included to ensure that the expert is independent of the engaging party.

Part 6A.5 — Records of unclaimed consideration

This part is not relevant to the present discussion.

Part 6A.6 — ASIC powers

This part empowers ASIC to exempt persons from complying with a provision of Chapter 6A or to modify the compulsory acquisition provisions of Chapter 6A. This part will not be discussed further, other than to note that the modification power is likely to be invoked to address recently identified anomalies in Chapter 6A.

It now remains to outline Parts 6A.1 and 6A.2. The following outline is brief and selective. In particular, I will not discuss the procedural mechanics of initiating compulsory acquisition, as the relevant provisions in Part 6A.1 and Part 6A.2 do not raise any special issues. The principal objective of the outline below is to provide a foundation for discussing the key concept of 'fair value'.

Part 6A.1: Compulsory acquisitions and buy-outs following a takeover bid (sections 661A–663C)

Section 661A(1) permits compulsory acquisition of any class of securities which have been the subject of a takeover bid. This is an important extension of the law pre 13 March 2000. As noted earlier, before 13 March 2000, a takeover bid could only be made for voting shares, and compulsory acquisition applied only to voting shares (in the absence of ASIC relief). Now, a bidder

... a holder of securities covered by a compulsory acquisition notice ... may apply ... for an order that the securities not be compulsorily acquired.

wishing to acquire absolute control of a target that has issued not just ordinary shares but also convertible notes and or options may make a single takeover bid that applies to each of these classes of security issued by the target: see s 617 which provides that an off-market takeover bid may extend to include securities that will come to be in the 'bid class' (usually ordinary shares) during the offer period due to the conversion of or exercise of rights attached to other securities.

Where a bid is made to acquire all of the securities in the bid class, two conditions must be fulfilled to entitle the bidder to acquire compulsorily the outstanding securities (whether they be in the bid class or a class convertible into the bid class):

Condition 1 (s 661A(1)(b)(i))

The bidder¹ and its associates must have relevant interests² in at least 90% by number of the securities in the bid class. The 90% relevant interest must exist at the end of the offer period or at some time during the offer period. This second alternative — 'at some time during the offer period' — is intended to ensure that the entitlement to compulsory acquisition is not defeated by the possibility that the 90% threshold may be reached during the offer period but then diluted because the target issues further securities in the bid class, due to the exercise of options or the conversion of convertible securities.

Condition 2 (s 661A(1)(b)(ii))

The bidder and its associates must have acquired at least 75% by number of the securities that the bidder offered to acquire under the bid. This section calls for a determination of how many securities in the bid class were outstanding before the bid was announced. The bidder and its associates must have acquired at least 75% of that number.

Section 661A(3) provides that, even if the 90% and 75% thresholds have not been reached, the bidder may apply to the Court³ and request that it approve the bidder compulsorily acquiring securities in the bid class. Curiously, neither s 661A(3) nor the Explanatory Memorandum to the CLERP Act specifies any criteria for the Court granting its approval.

Importantly, s 661A(4)(b) and (c) provide that the bidder may elect to acquire shares that were issued or granted after the offer period ends, as well as shares that are issued up to six weeks after the bidder issues its compulsory acquisition notice under s 661B. Shares may be issued during either of these periods due to the exercise of options or the conversion of convertible notes. Therefore, ss 661A(4)(b) and (c) assist a bidder to maintain 100% control. These provisions help overcome the problem under the old law where a bidder, having acquired 100% control, risked slipping below 100% because of the subsequent issue of new shares on exercise of options or the conversion of convertible notes.

Significantly, a holder of securities covered by a compulsory acquisition notice under s 661B may apply to the Court for an order that the securities not be compulsorily acquired. The Court may make such an order only if it is satisfied that the consideration is not 'fair value' for the securities: s 661E. We examine the meaning of 'fair value' later in this article.



Part 6A.2: General compulsory acquisitions and buy-outs (ss 664A–665C)

Section 664A(3) introduces a new compulsory acquisition right into Australian law. This section provides that ‘a 90 holder in relation to a class of securities of a company’ may compulsorily acquire all the remaining securities in that class. The consideration must be cash and all exiting shareholder must receive the same amount of cash for their securities (s 664B). The 90% holder must obtain an expert’s report that expresses an opinion on whether that cash sum represents a ‘fair value’ for the securities concerned (ss 664C(2)(b)(ii), 667A).

A person is ‘a 90% holder in relation to a class of securities’ if the person holds alone or through related companies a full beneficial interest in at least 90% by value of all securities in the company that are either shares or convertible into shares (ss 664AA(1) and (2)). Importantly, there is no need for a 90% holder to have acquired its 90% beneficial interest through an immediately preceding takeover bid. Indeed, if a person becomes a ‘90% holder’ through acceptances of personal offers that it has made under a takeover bid, that ‘90% holder’ would arguably have no scope to elect between the compulsory acquisition machinery in Part 6A.1 (Div 1) and that in Part 6A.2. There are two arguments in favour of this view.

- The title of Part 6A.1 is

‘Compulsory acquisitions and buy-outs following takeover bid’ (emphasis added). This title suggests that the purpose of Part 6A.1 (Div 1) is to establish a specific regime for compulsory acquisition following a takeover bid. If Part 6A.2 could fulfil the role of Part 6A.1 (Div 1), why did the legislature enact Part 6A.1 (Div 1)?

- If a bidder is eligible to proceed to compulsory acquisition under Part 6A.1 (Div 1) but fails to do so within one month after the offer period ends, this would activate Part 6A.1 (Div 2). In other words, the bidder in these circumstances will have a positive obligation to send out notices to minority shareholders advising them of their right to be bought out. The contrary argument is that there is nothing in Part 6A.2 that expressly excludes a takeover bidder from being a ‘90% holder’ within the meaning of ss 664AA(1) and (2). If the legislature had intended Part 6A.1 and Part 6A.2 to be mutually exclusive regimes, it would have been a simple matter to draft the appropriate carve outs⁴.

Part 6A.2 is flexible in that all that is required is that the person is ‘a 90% holder’, in the terms described above (with the possible implicit exclusion of 90% holders who have attained that status from an immediately preceding takeover bid). Therefore, the compulsory acquisition right in s 664A(3) is available in any proprietary limited

company, despite an initial proposal to exclude companies with 15 or fewer members from the new right. In the listed company context, the compulsory acquisition right in s 664A(3) could be invoked if, for example, a 75% shareholder moves to 90% over a number of years by permitted exceptions to the central prohibition in s 606.⁵ The permitted exceptions that are likely to be most relevant are further shares acquired under a rights issue, a dividend reinvestment plan or a bonus share scheme;⁶ a placement of new shares to the relevant shareholder with the approval of the company’s shareholders in general meeting;⁷ or creeping acquisitions (3% every six months).⁸

A ‘90% holder’ wishing to initiate compulsory acquisition under s 664A(3) must do so within six months after becoming a 90% holder. However, a person who is a 90% holder as at 13 March 2000 (the date s 664A(3) commenced) has until 12 March 2001 to initiate compulsory acquisition under s 664A(3). The compulsory acquisition right given to a 90% holder under s 664A(3) is subject to a number of disqualifying grounds. The one that is relevant to this discussion is the objection ground. A person who holds securities covered by s 664A(3) may object to the compulsory acquisition of their securities by signing the objection form accompanying the compulsory acquisition notice and returning it to the 90% holder (s 664E(1)). If there are objectors who hold between them at least 10% by value of the remaining securities at the end of the objection period, the 90% holder prima facie loses the right of compulsory acquisition (s 664A(3)(b)). However, the 90% holder may seek to revive the right by applying to the Court under s 664F to approve the acquisition of the securities covered by s 664A(3). The Court must approve the compulsory acquisition of the

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securities covered by s 664A(3) if the 90% holder establishes that the terms of compulsory acquisition give 'a fair value for the securities' (s 664F).

From the above overview of Chapter 6A, it is apparent that the concept of 'fair value' permeates Chapter 6A. Specifically, 'fair value' arises:

- for an expert's report required under ss 663B(1)(c)(ii), 664C(2)(b)(ii) or 665B(1)(c)(ii);
- for the Court to consider under s 661E if just one holder of securities covered by a compulsory acquisition notice under s 661B objects; and
- for the Court to consider under s 664F(3), if at least 10% of holders covered by a compulsory acquisition notice under s 664C object.

The meaning of 'fair value' under Chapter 6A

The central provision on determining 'fair value' is s 667C(1). It provides:

To determine what is fair value for securities for the purposes of this Chapter:

- first assess the value of the Company as a whole
- then allocate that value among the classes of issued securities in the company (taking into account the relative financial risk and voting and distribution rights of the classes)
- then allocate the value of each class pro rata among the securities in that class (without allowing a premium or applying a discount for particular securities in that class).'

No guidance is given on how to discharge the first step of 'assessing the value of the company as a whole'. Admittedly, there is a considerable amount of Australian

finance literature on the principles and practice of valuing companies.⁹ However, there is always scope for a range of credible valuations, meaning that 'assessing the value of the company as a whole' will not be a simple exercise for the Court in an objection proceeding under either s 661E or s 664F(3). The potential for uncertainty and dispute in valuation exercises is apparent in the United States' appraisal doctrine. Appraisal is statutory exit

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mechanism that has been available in most American states for over 100 years. Appraisal allows a minority shareholder that is opposed to a fundamental corporate change (e.g. a merger, the sale of the company's principal undertaking or a change in nature of the company's business) to compel the company to buy back the shareholder's shares at a price equivalent to their 'fair value'. The court determines fair value in the absence of agreement. In recent years, there has been a proliferation of appraisal cases where the courts have had to reconcile partisan and dramatically divergent expert estimates of 'fair value'. Similar difficulties have been reported in Canada where a statutory appraisal remedy is also available.

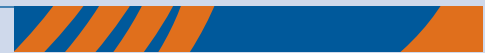
The CLERP Act has sought to avoid the 'dueling experts problem' by providing that the expert conducting the valuation for the majority shareholder must be a neutral person nominated by ASIC

who is not associated with the majority shareholder (ss 667AA and 667B). This should help avoid a situation where, in objection proceedings, the Court might otherwise discount the integrity of the majority shareholder's expert's report in an effort to reconcile it with a perhaps equally partisan report commissioned by the objecting minority.

Having assessed the value of the company as a whole and allocated that value among the classes of issued securities, limb (c) of s 667C(1) provides that the Court or the independent expert (as the case may be) must then 'allocate the value of each class pro rata among the securities in that class (without allowing a premium or applying a discount for particular securities in that class)'. Limb (c) appears to be a codification of a number of Australian cases¹⁰ where the courts have accepted that the value of a minority shareholding should be pro rata to the value of that class of shares as a whole, without any discount for the minority shareholding. Not discounting a minority parcel of shares is also consistent with the approach the United States courts have adopted in relation to the appraisal doctrine.

Relevant case law

In *Winpar Holdings*, Santow J turned to s 667C(1) for guidance in interpreting the words 'fair and reasonable' under the new selective reduction of capital provisions. Although s 667C(1) speaks of 'fair value' and s 256B(1)(a) speaks of a capital reduction being 'fair and reasonable to the company's shareholders as a whole', Santow J considered that it is appropriate to interpret s 667C(1) and 256B(1)(a) in a manner which gives 'a harmonious, practical and mutually supportive operation to each of them'¹¹. His Honour observed that the effect of s 667C(1)(c) is that:



...the acquirer's 90% or more is not allowed to command any (notional) premium as against the minority's 10% or less, in calculating what is paid for the minority under s 667C...The collective value of the company as a whole including any special value derived from 100% ownership is to be allocated without attributing a premium or discount to particular securities firstly within a class, including for example a key holding from within this minority holding compulsorily acquired, and secondly as between majority and minority. Thus that value should be allocated pro rata, though clearly the acquirer may choose to be more generous. Thus while an expert is ordinarily required to take into account the special value 100% ownership may have to a majority holder in working out the total value of the company, fairness requires that special value to be allocated pro rata.¹²

The main criticism that has been directed at the new compulsory acquisition regime in Chapter 6A is that the Court's role, if it is invoked, is confined to approving or disapproving compulsory acquisition solely on the basis of whether or not the price is 'fair'. One commentator notes that there may be other aspects to the compulsory acquisition which are unfair or coercive, and that the Court had the power to conduct a more wide-ranging examination of unfairness under the former compulsory acquisition regime.¹³

Conclusion

Controversially, the new compulsory acquisition right given to a 90% holder under Part 6A.2 of the Corporations Law means that, provided a fair value is paid (and other technical requirements are met), minority shareholders in a proprietary company arguably have no basis for resisting the expropriation of their shares. Perhaps one avenue through which minority shareholders in a proprietary company could resist the

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expropriation of their shares under Part 6A.2 is to apply under s 234(c) for an order under s 233 that the compulsory acquisition of the minority shares is oppressive within the terms of s 232(e).

- 1 See s 9 for the meaning of bidder's 'associates'.
- 2 Sections 608 and 609 set out the rules for measuring a person's relevant interest.
- 3 In this paper, all references to the 'Court' have the meaning given by s 58AA of Corporations Law. However, that section must be read in light of the High Court's decision in *Re Wakim; Ex parte McNally* (1999) 163 ALR 270. In that case, the High Court held that the cross vesting provisions in Part 9 of the Corporations Act of each State and Territory are ineffective because they are unconstitutional. The High Court's decision has had the effect of removing Federal Court jurisdiction over most Corporations Law matters.
- 4 Assuming a bidder does have a choice between compulsory acquisition under Part 6A.1 (Div 1) or under Part 6A.2, a bidder might still prefer to proceed under Part 6A.1 (Div 1). Compulsory acquisition under Part 6A.2 must be by cash. That may not suit a bidder who has made a purely scrip offer. On the other hand, compulsory acquisition under Part 6A.2 offers the following advantages over Part 6A.1 (Div 1). First, as discussed later, the scope for objection under Part 6A.2 is set higher than

under Part 6A.1 (Div 1). Secondly, Part 6A.2 allows more time to implement compulsory acquisition.

- 5 Section 606 prohibits a person from acquiring a relevant interest in issued voting shares in a company if:
 - (a) the company is a listed company or an unlisted company with more than 50 shareholders
 - (b) the person acquiring the interest does so through a transaction in relation to securities entered into by or on behalf of that person and
 - (c) because of that 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 greater than 20% and below 90%.
- 6 See s 611(10), (11)
- 7 See s 611(7)
- 8 See s 611(9)
- 9 See eg. W Lonergan, *The Valuation of Businesses, Shares & Other Equity* (Woodslane) 3rd ed 1998; W Lonergan, 'The Changing Nature of Discounts for Minorities', July 1999 *Law Society Journal* 66; and W Lonergan, 'Fair Value, Market Value or Fair Market Value?' June 2000 *Law Society Journal* 46.
- 10 See *Dynasty v Coombs* (1995) 13 ACLC 1290; *Holt v Cox* (1994) 13 ACLC 92; *Re Dalkeith Investments Pty Ltd* (1983) 3 ACLC 74; *Re Golden Bread Pty Ltd* (1977) 2 ACLR 188.
- 11 (2000) 18 ACLC 665 at 678, quoting with approval from Kirby P's judgment in *Catto v Ampol* (1989) 7 ACLC 717 at 720.
- 12 (2000) 18 ACLC 665 at 677
- 13 E Boros 'Compulsory acquisition of minority shareholdings — the way forward?' (1998) 16 C&SLJ 279 at 291.

