

# **CORPORATE AND FINANCIAL SERVICES REGULATION REVIEW PROPOSALS PAPER 2006**

## **DRAFT REGULATION IMPACT STATEMENT**

### **CHAPTER 6 - TAKEOVERS**

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## 1. BACKGROUND

Subdivision D, Division 5, Part 6.5 of the *Corporations Act 2001* (Corporations Act) became effective in March 2002. That subdivision introduces a requirement for bidders and targets who made telephone calls to shareholders (other than wholesale shareholders) during the bid period to make and store recordings of those calls. It is understood telephone monitoring was not common practice for participants in a takeover bid situation prior to the introduction of the requirements in that subdivision (telephone monitoring requirements).

## 2. PROBLEM IDENTIFICATION

The telephone monitoring requirements impose significant costs on takeover bidders and targets. Experience with the requirements suggests the costs of complying with the telephone monitoring requirements exceed the benefits that retail shareholders derive from their existence.

### Overview of takeovers legislation

- The takeovers provisions apply to listed companies and managed investment schemes, and unlisted companies with more than 50 members.
- The takeovers provisions are designed to ensure that acquisition of control of certain classes of company occur in an efficient, competitive and informed market. The provisions seek to ensure shareholders as well as other market participants are able to access information about the takeover and its participants that enable them to assess the merits of particular proposals in a timely manner.
- The provisions require participants in for example, off-market takeover bids to provide shareholders with bidder's and target's statements which will ensure shareholders are in possession of the information needed to make informed decisions about their shareholding.
  - Section 636 of the Corporations Act states that bidder's statements are to include such information as: the identity of the bidder; the bidder's intentions with regards to the future of the company; the bidder's plans with regards to the employment of existing employees of the company; and the consideration being offered for the interest in the target company.
  - Section 638 of the Corporations Act requires that target's statements are to include information which would be considered reasonable for investors and their professional advisers to find in the statement, when that information is available to directors of the target company.
- Shareholders are expected to rely on the formal documentation received.
- The aim of telephone contact by bidders or targets with shareholders during the bid period is to answer questions about process or to encourage acceptance or rejection of the offer.

## Telephone monitoring requirements

- During a bid period, shareholders may be contacted or will be given the opportunity to contact representatives of the bidder and target to discuss the proposed takeover. The objective of the policy was to provide a greater level of protection for smaller shareholders from potential breaches of the Corporations Act. As such, it is vital that shareholders are provided with accurate and useful information in a timeframe which gives them adequate opportunity to consider the implications of any decisions they might make. It should be noted that the intention of the use of telephone conversations in takeover scenarios was not to necessarily provide retail shareholders with additional information, but to canvas the opinions of shareholders in relation to the proposed takeover.
- The Australian Securities and Investments Commission (ASIC) is ultimately responsible for ensuring companies meet their obligations under the Corporations Act. There are no formal reporting requirements in place that result in companies providing ASIC with evidence of adherence to the monitoring requirements. ASIC can, however, make inquiries about and formally investigate possible breaches of the provisions. The telephone monitoring provisions are backed by criminal penalties – see Items 201A to 201M of Schedule 3 to the Corporations Act. There is also the possibility of a court order under section 1325A in response to a proved contravention.
- Although companies are not required to regularly provide evidence of their compliance with the monitoring requirement, bidders and targets in a takeover situation may provide scripts to be used in telephone conversations with shareholders to ASIC to ensure shareholders are not exposed to misleading or inappropriate advice.
- The telephone monitoring provisions are not directly linked to a specific civil liability provision. However, they may assist in providing evidence for those shareholders initiating civil action against the bidder/target for, for example, misleading or deceptive conduct.

## Perceived deficiencies

- *Imposition of unnecessary costs on business* — The telephone monitoring requirements oblige participants in a takeover bid as either bidder or target, to record and store all telephone conversations made by their representatives to retail shareholders during a bid period. The costs and processes currently associated with the monitoring and resultant storing of these telephone conversations is considered by respondents to the Government's Corporate and Financial Services Regulation (CFSR) Review consultation paper to be an excessive burden.
- *Failure to increase shareholder protection*— There is no evidence to suggest that the current requirements have increased shareholder protection.
  - There have been few, if any, attempts to access recordings of telephone conversations in relation to litigation by retail shareholders since the introduction of the telephone monitoring requirements.
  - Prior to the introduction of the telephone monitoring requirements there was limited anecdotal evidence to suggest the existence of problems with telephone conversations between bid participants. It is unlikely that the provisions have prevented an increase in the rate of litigation on this matter.

### **3. OBJECTIVE**

The objective is to remove unnecessary regulation and compliance costs without sacrificing protection of retail shareholders during takeover bid periods.

### **4. OPTIONS**

The options noted below provide possible courses of action that may be taken on this matter.

Option A – Remove current telephone monitoring requirement and enable business to monitor its own practices.

Option B – Require telephone monitoring only where there is a substantial number of retail persons on the share register.

Option C – No action.

### **5. IMPACT ANALYSIS**

#### **5.1 Impact assessment methodology**

Impacts are divided between three impact groups (consumers, business and government). Typical impacts of an option on consumers might be changes in access to a market, the level of information and disclosure provided, or prices of goods or services. Typical impacts of an option on business would be the changes in the costs of compliance with a regulatory requirement. Typical impacts on government might be the costs of administering a regulatory requirement. Some impacts, such as changes in overall confidence in a market, may impact on more than one impact group.

The assessment of impacts in this draft regulation statement is based on a seven-point scale (-3 to +3). The impacts of each option are compared with the equivalent impact of the 'do nothing' option. If an impact on the impact group would, relative to doing nothing, be beneficial, the impact is allocated a positive rating of +1 to +3, depending on the magnitude of the relative benefit. On the other hand, if the impact imposes an additional cost on the impact group relative to the status quo, the impact is allocated a negative rating of -1 to -3, depending on the magnitude of the relative cost. If the impact is the same as that imposed under the current situation, a zero score would be given (although usually the impact would not be listed in such a case).

The magnitude of the rating of a particular impact associated with an option has been assigned taking into account the overall potential impact on the impact group. The reference point is always the status quo (or 'do nothing' option). Whether the cost or benefit is one-off or recurring, and whether it would fall on a small or large proportion of the impact group (in the case of business and consumers), is factored into the rating. For example, a cost or benefit, even though large for the persons concerned, may not result in the maximum rating (+/-3) if it is a one-off event that only falls on a few individuals. Conversely, a small increase in costs or benefits might be given a moderate or high rating if it would be likely to recur or if it falls on a large proportion of the impact group. The rating scale for individual impacts is explained in the table below.

### Rating an individual impact

+3	+2	+1	0	-1	-2	-3
Large benefit/ advantage compared to 'do nothing'	Moderate benefit/ advantage compared to 'do nothing'	Small benefit/ advantage compared to 'do nothing'	No substantial change from do nothing	Small cost/ disadvantage compared to 'do nothing'	Moderate cost/ disadvantage compared to 'do nothing'	Large cost/ disadvantage compared to 'do nothing'

The ratings for the individual impacts compared to the status quo are then tallied to produce an overall outcome for the option. If it is positive, it indicates that the option is likely to produce a more favourable cost/benefit ratio than the status quo. If it is zero there would be no overall benefit from adopting the option, and if negative the option would provide overall a less favourable cost/benefit ratio than the 'do nothing' option. Ordinarily, options that have the highest positive score would be the favoured courses of action.

What is classed as a 'large', 'moderate' or 'small' cost or benefit depends on the nature of the problem and options being considered. Of course, the costs and benefits associated with options to address a problem costing billions of dollars per year are likely to be of a much greater absolute magnitude than the costs and benefits of options for dealing with a rather modest issue that effects only a handful of persons. However, as all the ratings are made relative to the status quo/ do nothing option for a particular problem, the absolute value of 'large' or 'moderate' or 'small' is not really important. All that matters is that within a problem assessment, the impacts of each option are given appropriate ratings relative to the status quo and each other. If that occurs, it will be sufficient for the methodology to yield an overall rating that assists in assessing the relative merits of options, from a cost/benefit perspective, to address the particular problem.

An example of the rating calculation for an option, using the seven-point scale ratings of impacts, is in the table below. The example is based on a purely hypothetical scenario that a new type of long-wearing vehicle tyre is being sold and marketed, but it has become apparent that the new tyres have a higher risk of exploding while in motion than conventional tyres. The example is designed merely to illustrate how the rating scale might be used to compare a proposal's costs and benefits option to the 'do nothing' option – it is not intended to be a comprehensive or realistic assessment of options to address such a problem.

#### Illustrative rating for the problem of a long-wearing tyre that may fail

##### Option A: Do nothing

	Benefits	Costs
Consumers	Access to a cheaper solution for vehicle tyres	Risk of tyre failure that can result in personal and property damage as a result of collision. Damage can be severe but cases are rare.
Industry		Some compensation payments to persons as a result of collisions caused by the tyre
Government	Advantages from a waste management perspective	

**Option B: Ban on sale of the new tyre**

	Benefits	Costs
Consumers	No persons will not be affected by tyre failure and resultant damage (+3)	Lack of access by all consumers to long-wearing vehicle tyres, increasing the cost of vehicle maintenance (-2)
Industry	No compensation payments for accident victims (+1)	Transitional costs involved with switching back all manufacturing/marketing operations to conventional tyres (-3)
Government		Conventional tyres produce more waste which is costly to deal with (-1)
Sub-rating	+4	-6
Overall rating	-2	

**Option C: Industry-developed quality control standards**

	Benefits	Costs
Consumers	Much lower risk of tyre failure and resultant damage than status quo (+2)	
Industry	Significantly less compensation payments for accident victims (+1)	Developing and monitoring industry-wide quality control standards (-2)
Government		
Sub-rating	+3	-2
Overall rating	+1	

In the above hypothetical example, Option C appears to have a better impact for consumers and a better overall cost/benefit rating than Option B. Although Option B appears to offer a slightly better impact for consumers, it appears to be less effective from an overall cost/benefit perspective than Option C.

The suggested ratings in this draft regulation impact statement are preliminary and are intended to promote consideration and comment by stakeholders to assist with final quantification of the expected costs and benefits. Comments are sought on the suggested ratings, and submission of further information to assist in quantifying costs/benefits is encouraged. Where possible, a quantified assessment of costs and benefits will be included in the final version of the regulation impact statement.

**5.3 Impact group identification**

Groups that will be affected by the proposed amendments include:

- Bidders and targets in a takeover situation;
- Retail shareholders of companies that are the target of a takeover; and
- Government and regulators.

## 5.4 Impact of options on existing regulations

As this proposal will result in the removal of an existing requirement, there will be no duplication or conflict with existing regulations and requirements. Similarly, the removal of the requirement to monitor the relevant telephone conversations would not require amendments to or repealing of any other legislation.

## 5.5 Expected benefits and costs

### Option A: No action

	Benefits	Costs
Consumers	Recordings may assist retail shareholders with litigation regarding telephone calls during bid periods.	Costs of recording and storing copies of all telephone conversations with retail investors.
Industry		
Government		

### Option B: Require telephone monitoring only where there are a substantial number of retail persons on the share register.

	Benefits	Costs
Consumers	Some scenarios currently covered by the requirements would no longer be covered. [+1]	Recordings would not be available to those retail shareholders who own shares in companies with relatively few retail shareholders. [-1]
Industry		This option would involve additional expenditure for business in establishing whether the company in question has a substantial retail shareholder base. [-1]
Government		
Sub-rating	1	-2
Overall rating		-1

### Option C: Remove current telephone monitoring requirements.

	Benefits	Costs
Consumers	This option would remove costs currently borne by targets and bidders in a takeover. [+3]	Recordings would not be available to any retail shareholders. [-2]
Industry		
Government		
Sub-rating	3	-2
Overall rating		1

**Request for comment**

Are there any options which should be considered as alternatives to those listed?

Are there additional costs and benefits for the above options, which are not listed?

Information to assist with quantification of costs and benefits is sought for inclusion in the final regulation impact statement.

Are the suggested relative ratings appropriate?

**6. CONSULTATION**

Option A received overwhelming support from all stakeholders who responded to the CFSR Review Consultation Paper. Comments from stakeholders indicated that the monitoring and resultant storing of telephone conversations during company takeovers offer no benefit to either the companies in question or individual retail shareholders.

No concerns for the proposed removal of this provision have been raised in consultation undertaken to date.

**7. CONCLUSION AND RECOMMENDATION**

The current legislative requirement does not meet its desired outcomes, namely the provision of increased shareholder protection, by securing sound recordings of any advice provided by representatives of bidders and targets in a takeover. The requirement to record and store all telephone conversations that occur between retail shareholders and the participants in a takeover have added an unnecessary layer of complexity to the takeover process. To impose this requirement upon certain groups of companies (as suggested in Option B) would involve costs in establishing whether the particular company is subject to the provisions. Further, it would be inequitable to hold out protection to some investors because they hold shares in companies which have high numbers of retail shareholders.

Option A proposes retaining the current requirements. Experience suggests that since its introduction, the requirement to monitor and store relevant telephone conversations has not provided any significant protections for retail shareholders but has imposed costs.

Option B, retaining the current requirements for takeover bids with significant numbers of retail shareholders, retains some measure of protections for some retail shareholders. However, the option imposes additional costs on business in establishing whether they fall into the category of companies required to monitor telephone conversations and, as mentioned above, the benefits to retail shareholders are not significant.

Option C proposes the removal of the telephone monitoring requirements altogether. Removing the requirement will completely remove costs currently borne by business. Although it also completely removes the protection to retail shareholders, it appears that the benefits were not significant in practice. This is the preferred option.

**Request for comment**

Is there any quantitative information about the cost associated with implementing and maintaining the current system?

Are there significant risks associated with removing the current requirements not addressed in this analysis?

## **8. IMPLEMENTATION AND REVIEW**

The recommended action will require amendments to the Corporations Act to remove the current requirements.

No formal review has been scheduled. The operation of the Corporations Act will be under continuous monitoring and adjustments or refinements to the proposed amendments will be made as required.