a more general gatekeeper function, particularly in relation to organic changes or transactions affected by directors' conflicts of interest. The exercise of some powers requires a special resolution.

Decisions taken by the general meeting will be efficacious only if they comply with procedural and disclosure requirements designed to protect the integrity of those decisions themselves. Irregularities may, however, be cured in some circumstances by judicial order under s 1322. These procedural requirements relate to the convening and conduct of general meetings, notices and circulars distributed to members, and voting at meetings. They are the subject of this chapter. These provisions may apply also to meetings of a class of members, of debenture holders and of other creditors under specific provisions of the Act or under the terms of the instrument creating the interests.

The concerns of this chapter are not, however, purely technical. As we have seen ([2.195]), institutional shareholders engage with company management more or less continuously and are encouraged to do so by industry standards of responsible share ownership. Nevertheless, the general meeting of members remains a central institution of shareholder engagement even if it is now perhaps of greater significance for retail than institutional shareholders in public companies. It provides a physical forum, often augmented by technology, for reporting to shareholders through the annual report in the case of public companies, questioning management, discussing and deliberating on matters for decision in the meeting, and voting on those matters that require collective shareholder decision.The general meeting is the forum for members to exercise such control prerogatives as they possess collectively; indeed, it may be the site for contests for corporate control, through contested director elections or for approval of a transaction that will transfer control or affect its distribution. No less dramatically, the general meeting may be a site through which social and environmental claims upon the company are ventilated with the drama of contest in a public forum. The legitimacy of this use of shareholder meetings has been strongly contested: see [6.40].

This contested use of shareholder meetings, and the industry promotion of continuous institutional shareholder engagement, prompts questions as to the purpose general meetings perform and whether these purposes might be better served by other measures.[1] The status of shareholder meetings has changed dramatically over time, from the sovereign group within the corporation to a body whose formal control prerogatives have in many publicly held companies been effectively ceded to the board through the combined effect of the dispersal of shareholdings and the operation of proxy voting mechanisms: see [2.185] and [6.85]. The sheer number of shareholders in many publicly held companies makes the holding of physical meetings very difficult, even for the minority of shareholders who choose to attend, despite the use of audio-visual communications to simultaneously link several sites together. Would an asynchronous virtual meeting offer a superior alternative to the physical meeting? What other models might be fashioned? At the base of these questions is a more fundamental question: in view of these developments, what is the proper role and entitlement of shareholders in the modern publicly held company?

1 See Corporations and Markets Advisory Committee, *The AGM and Shareholder Engagement, Discussion Paper* (2012), chap 6; Parliamentary Joint Committee on Corporations and Financial Services, *Better shareholders – Better company: Shareholder engagement and participation in Australia* (2008); Chartered Secretaries Australia, *Rethinking the AGM: A Discussion Paper* (2008); Blake Dawson Waldron, *2006 AGMs: Review and Results* (2007); Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Company*, Final Report (2000); R Simmonds (2001) 19 C & SLJ 506; D Birnhak (2003) 29 Rutgers Comp & Tech LJ 423.

ALTERNATIVES TO MEETINGS

[6.10] The ritual of a periodic general meeting is a necessary part of corporate life for some but not the majority of companies. A public company (other than a single member company) must hold an annual general meeting (AGM) at least once in every calendar year and within five months after the end of its financial year: s 250N(2). The company's annual financial report, directors' report and auditor's report must be laid before the meeting: s 317 and see [9.130]. Whether or not it is referred to in the notice of meeting, the business of the AGM includes

- consideration of these reports
- the election of directors
- the appointment of the auditor and
- fixing the auditor's remuneration: s 250R.

Otherwise, the Act does not prescribe that a periodic general meeting shall be held or what its business shall be.[2]

Of course, a general meeting may be held for a number of purposes under the Act or a company's constitution, quite independently of the requirement of an AGM. These include the sanctioning of capital transactions or those affected by affinity relationships involving directors (for example, related party transactions under Ch 2E). Often, of course, to reduce expense these approvals will be sought at an AGM. While the requirement to hold a general meeting may arise from myriad provisions throughout the Act, it regulates in Pt 2G.2 the convening and conduct of those meetings that are held pursuant to some particular provision of the Act or under a company's constitution.

At the other end of the size spectrum, the Act obviates the need for a meeting of members by providing an informal procedure for passing members' resolutions in single member companies and in proprietary companies generally. A single member company may pass a resolution simply by the member recording it and signing the record: s 249B(1). A proprietary company with more than one member may pass a resolution without a general meeting being held if all the members entitled to vote on the resolution sign a document containing a statement that they are in favour of the resolution set out in the document: s 249A(2). This circulating resolution facility applies to ordinary and special resolutions required or permitted under the Act or a company's constitution except a resolution to remove an auditor under s 329: s 249A(1). Any document that would otherwise have been given to members if the resolution were being proposed at a general meeting must be distributed with the circulating minute: s 249A(5)(a). The facility does not derogate from general law doctrines relating to the effect of informal shareholder consensus: s 249A(7) and see [5.155].

CONVENING THE GENERAL MEETING

Directors' powers to convene meetings

[6.15] The Act and company constitutions provide multiple modes of convening general meetings. In many situations the provisions of the constitution and the Act will provide

2 Following an older usage retained in the constitutions of some companies, general meetings other than an AGM are sometimes referred to as extraordinary general meetings or EGMs. Alternatively, they are called special meetings.

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parallel provisions differing, if at all, only in the time limits within which action may be taken. Under standard constitutional provisions and the Act, the general meeting may be convened by

- an individual director
- the board of directors
- a member or group of members satisfying a minimum numerical or voting standard or
- a court order.

A company's constitution will usually make provision for calling a general meeting although the Act provides a replaceable rule authorising a director to call a general meeting: s 249C. In the case of a listed company incorporated in Australia, the rule is mandatory and applies notwithstanding anything in the company's constitution: s 249CA.

The board of directors enjoys an inherent power to convene a general meeting. Indeed, in practice, general meetings are usually convened by a notice signed by the company secretary pursuant to a resolution of directors.

Even when the power to convene a meeting is exercised by an individual director, it is a fiduciary power to be exercised for the benefit of the company as a whole, and not for the benefit of the directors or a group of shareholders of the company.[3] This general law doctrine was introduced into the Act in 1998 with the requirement that a general meeting must be held for a proper purpose: s 249Q: see [6.35] and [6.70].[4]

A general meeting must be held at a reasonable time and place: s 249R. The provision has been interpreted as not creating any substantive law in view of the constraints of the fiduciary obligation attaching to the exercise of the convening powers by directors or by shareholder requisitionists who stand in their shoes under statutory procedures: see [6.30]. In one case, the court held that the time of 6 pm on 30 December was not an inherently unreasonable time.[5] The governing principles and their application are explored in the following extract.

Smith v Sadler

[6.20] *Smith v Sadler* (1997) 25 ACSR 672 Supreme Court of New South Wales

[A company's AGM was convened to be held on premises licensed under the then *Liquor Act 1982* (NSW) of which premises the defendant was licensee. The defendant would not permit the plaintiff member to enter upon the premises because he was apprehensive about the plaintiff's conduct and owed a duty under the *Liquor Act* to ensure that no disturbance occurred upon licensed premises. The plaintiff sought to restrain his exclusion from attending the AGM.]

YOUNG J: [673] It is clear that at the time when the notice convening the meeting was issued the problem about the plaintiff going onto the premises where the meeting was to be held was a very real one. It seemed to me that because this was known to the board of the co-operative, the convening of the meeting may be invalid.

Although in some circumstances the board of a company or co-operative may be able to convene a meeting without any constraint (see, eg, *Campbell v Lowe's Inc* 134A (2d) 852 (Del Ch 1957) at 856) in general, directors have a fiduciary duty to convene meetings, particularly annual general meetings at a time and a place where all members of the company present in the state will be able to attend.

3 *Australian Innovation Ltd v Petrovsky* (1996) 21 ACSR 218 at 222; see also [7.215] for an overview of remedies and their outcomes.

4 The section does not, however, introduce any new substantive law: *Howard v Mechtler* (1999) 30 ACSR 434 at 442.

5 *Howard v Mechtler* (1999) 30 ACSR 434 at 442.

Smith v Sadler cont.

In *Albert E Touchet Inc v Touchet* 163 NE 184 (Mass 1928) Rugg CJ emphasised at 188 that the right to participate in the annual general meeting and the right to vote at elections held at that meeting is a right that is inherent in the ownership of the stock. Thus it is not competent for the board of directors to frustrate that right by either not holding a meeting or holding it at a time or place where it is almost impossible for some shareholders to attend: see also *Camden & Atlantic Railroad v Elkins* 37 NJ Eq (10 Stew) 273 at 276.

In *Coombs v Dynasty Pty Ltd* (1994) 14 ACSR 60 at 93, von Doussa J said:

> An annual general meeting is not a mere formality, particularly for members who have no opportunity to ask questions about the affairs of the company. To hold a meeting at a time and place where members are unlikely to be able to attend is tantamount to not holding a meeting at all.

I respectfully agree.

The rules of the co-operative are in evidence. Rule 28 provides that the Annual General Meeting is to be held "at such place as the Board may determine". The rule in this general form does not exclude the fiduciary duty noted above. So directors must turn their minds to an appropriate place at which all members of the co-operative within the state could attend as of right. They cannot choose a place where they have reason to suspect that one or more members will be excluded by the person in control of the specified premises.

There were a series of situations about 30 years ago where companies deliberately scheduled annual general meetings in obscure upstate towns during [674] the festive season. In some countries, this practice was curbed by the regulatory authorities. Where this has not occurred and for private companies and co-operatives, the practice is controlled by the court policing fiduciary duties not to use the power to convene a meeting as a cloak for fraud. In other words, it is ordinarily a fraud on the power to convene a meeting at a time and place when or where at least one member cannot lawfully attend. Obviously this proposition does not apply where a member is in gaol or overseas or merely finds it inconvenient to attend at the specified time and place.

After these matters were ventilated, the parties assessed their position and I am able to make the orders ensuring that the plaintiff can attend the meeting, but requiring that it be adjourned for an hour so that those who are present in court will be able to travel to [the meeting] and attend it.

It seemed to me that had this consensus not been reached, it would have been necessary to order that the meeting only transact formal business and then adjourn to premises where the plaintiff had a right to attend. In this way the court would cause minimum disruption to the 250 people who may well attend the meeting but still permit the plaintiff to attend. Such an order would get over the problem that the defendant had the right to control who came onto his licensed premises, as well as the principle that the court does not lightly prevent people from meeting: see *Uniting Church of Australia Property Trust (NSW) v Macquarie Radio Network Pty Ltd* (1997) 24 ACSR 721.

Members' direct right to convene a meeting

[6.25] Members possess two distinct statutory rights to convene meetings. The first is a direct right to convene a meeting at their own expense. The second is the right to requisition directors to call a meeting and, if directors fail to do so, to convene it themselves. The second mode is discussed at [6.30].

As for the first mode, members with at least 5 per cent of the votes that may be cast at a general meeting may convene a general meeting at their own expense: s 249F(1). The general meeting must be called in the same way, so far as possible, in which general meetings of the

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company may be called: s 249F(2).[6] Directors may only postpone such a general meeting if the company's constitution expressly permits them to do so – the general management power in s 198A is not sufficient to confer such authority.[7]

The direct right is likely to be of value in two situations. The first is where there are no directors to call meetings or if a company's constitution does not allow a director to call a meeting.[8] Secondly, a member might find a tactical advantage over directors in a contested meeting through their choice of its timing and venue, rather than leaving these matters to the directors' determination under a requisitioned meeting. This advantage comes at the price of bearing the expense of calling and holding the meeting.

Members may not convene a meeting for the purpose of passing a resolution that is beyond the constitutional power of the general meeting. This general law rule is reinforced from 1998 by a statutory requirement that general meetings must be held for a proper purpose: s 249Q. These limitations upon the power of direct convening are considered in [6.30] and [6.35] in the context of meetings convened by directors upon shareholder requisition.

Members' right to requisition a meeting

Voting power and numerical requirements

[6.30] The directors must call and arrange to hold a general meeting on the request of

(a) members with at least 5 per cent of the votes that may be cast at the meeting; or

(b) at least 100 members who are entitled to vote at the meeting: s 249D(1).

The request must be in writing, signed by the members, state any resolution to be proposed at the meeting and be given to the company: s 249D(2). Upon receipt of the request, the directors must call the meeting within 21 days for a date within two months of the requisition: s 249D(5). If the directors do not call and arrange a meeting within 21 days of a request under s 249D, requisitioning members with more than half of the votes of those who issued the request may themselves convene the meeting: s 249E(1). The meeting must be called in the same way, as far as possible, in which general meetings of the company may be called and must be held within three months of the members' request: s 249E(2). The company must give the requisitioning members, upon request and without charge, a copy of the register of members and must pay the members their reasonable expenses in convening the meeting: s 249E(3), (4). The company may recover those expenses from the directors who are jointly and individually

6 See further N Pathak & H Lauritsen (2005) 23 C & SLJ 283. Prior to 1998, the direct power to convene a general meeting applied only "so far as the articles do not make any other provision". A provision in a company's constitution which provided for requisitioning of a meeting by members was sufficient to displace the direct right to convene a general meeting even though the constitutional provision added nothing to members' statutory rights: *L C O'Neil Enterprises Pty Ltd v Toxic Treatments Ltd* (1986) 4 NSWLR 660. Indeed, the direct right to convene meetings under the former power might be displaced by any provision in the constitution specifying who may call a meeting, even one that confides the power to directors exclusively: *Re Totex-Adon Pty Ltd* [1980] 1 NSWLR 605 (see [6.55]); *Vision Nominees Pty Ltd v Pangea Resources Ltd* (1988) 14 NSWLR 38. Accordingly, the removal of this qualification upon the direct right significantly broadens its scope.

7 *McKerlie v Drillsearch Energy Ltd* (2009) 74 NSWLR 673 at [13]; *Carpathian Resources Ltd v Highmoor Business Corp* [2010] FCA 1294.

8 *Company Law Review Bill 1997, Explanatory Memorandum*, para 10.22. The alternative court procedure under s 249G is relatively costly and time consuming.

(that is, severally) liable for them unless individual directors establish that they took all reasonable steps to cause the directors to comply with their obligation to convene a meeting upon the requisition: s 249E(5).

The numerical test in s 249D(1) does not stipulate any minimum shareholding for each member joining in the requisition. Accordingly, it has been criticised upon the basis that, especially in its application to listed companies, it could result in a relatively small group of shareholders without any significant economic interest in the company validly requisitioning a general meeting to be conducted at the company's expense.[9] There has been considerable pressure from large companies either to abolish the numerical test entirely (and simply require 5 per cent voting power to requisition a meeting),[10] to raise it to a higher proportion of the company's membership[11] or to couple it with a minimum shareholding requirement for each member joining in the requisition.

A provision for prescribing a different number of members for a particular company or class of company might be made by regulation: s 249D(1A); however, a regulation which abolished the numerical requirement was disallowed by the Senate in 2000. In early 2005, the Commonwealth circulated draft legislation to remove the 100 member rule and require a minimum of 5 per cent of total voting share for the requisition of a special shareholder meeting. However, the proposal did not receive the support required under the Corporations Agreement (see [2.95]) from the States and Territories which were concerned that the amendment would work against the interests of minority shareholders, especially non-institutional investors.

Proper purpose

[6.35] A shareholder's right of requisition must be exercised bona fide and for a proper purpose: this general law rule is now partly expressed in the statutory requirement that general meetings must be held for a proper purpose (s 249Q) although this provision does no more than restate the general law.[12] Until the expiration of the period within which the directors must convene a meeting pursuant to the requisition, the requisitionist is entitled to act in its own interests provided only "that its requisition is bona fide, in that its objective is to have the resolutions passed and not simply to harass the company and its directors".[13] However, once

9 *Company Law Review Bill 1997, Explanatory Memorandum*, para 2.4. It was also said that the requisition power could also be used to give those shareholders undue leverage in negotiating with the company: *Company Law Review Bill 1997, Explanatory Memorandum*, para 2.4. Comparable jurisdictions in Europe and North America employ only an issued share capital test with thresholds ranging from 5 per cent to 20 per cent of voting capital: paras 2.7-2.10; for contrasting views on the utility of the 100 member rule, see P Darvas (2002) 20 C & SLJ 390 and S Milne & N Wakefield Evans (2003) 31 ABLR 285.

10 See, eg, the opinions expressed in Companies and Securities Advisory Committee, *Shareholder Participation in the Modern Listed Company*, Final Report (2000), paras 2.15-2.18. The Advisory Committee recommended the abolition of the numerical requirement.

11 For example, in the case of listed companies, to the figure that represents the numerical square root of the total number of members of the company; thus, for a company with 250,000 members, the numerical requirement would be 500 members: see M J Duffy (2002) 25 (2) UNSWLJ 434 at 441. Another variant, floated in response to criticism that the square root test would set too high a requirement, was to subject it to a cap of 500 and a minimum of 100.

12 "Why it was introduced is uncertain as it is accepted that it brought about no change in the existing common law": *NRMA Ltd v Snodgrass* (2001) ACSR 382 at [12].

13 *Adams v Adhesives Ltd* (1932) 32 SR (NSW) 398 at 401; *Humes Ltd v Unity APA Ltd* (1987) 11 ACLR 641 at 646; *Re Ariadne Australia Ltd* (1990) 2 ACSR 791 at 794; *Australian Innovation Ltd v Petrovsky* (1996) 21 ACSR 218.

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[9.05] A company may obtain finance for its operations from a number of sources. Shareholders, of course, subscribe for share capital. In addition, they usually contribute

towards what might loosely be called the capital fund by permitting the company to retain earnings otherwise available for dividends and by the creation of a variety of reserves. Shareholders in private companies often advance loan funds. For larger companies debt finance is a principal source of funds. This chapter is concerned with the principal sources of corporate finance, debt and equity (or share capital) finance.

This chapter initially surveys the several species of commercial finance and some principal incidents and the relative importance of each species of capital. The section also outlines the process of stock exchange listing and the quotation of equity and debt securities. Subsequently, the chapter examines serially

- some principal characteristics of debt finance;
- classes of share capital, in particular the rights attached to preference shares and the protection given to class rights generally;
- statutory requirements for corporate financial reporting including some concepts important to an understanding of share capital;
- legal rules relating to the reduction of share capital that underpin the protection of the capital fund to which shareholders subscribe against the threat of its dissipation contrary to creditor interests; and
- related doctrines touching the raising and maintenance of share capital.

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THE SOURCES OF CORPORATE FINANCE

Some functions of capital markets generally

[9.10] The capital markets (or financial system) serve the economic function of effecting transfers between those segments of a society with surplus resources for investment and those seeking funds for productive enterprise. Direct transfers may be made between savers and users as, for example, when governments issue bonds or other debt claims to households and other investors to finance their activities. However, in sophisticated economies financial intermediaries play a significant role in channelling flows between savers and borrowers. In the Australian financial system the principal financial intermediaries are the life insurance offices, pension and superannuation funds, unit trusts, finance companies, building societies and credit unions.

The term "capital markets" comprehends a series of diverse submarkets differentiated by the character of the financial intermediation employed or the nature of the financial claim issued. From the perspective of companies and securities law, the most important submarket is the cluster of markets known as the securities markets. The term "securities market" is sometimes used to refer to the market for government and semi-government securities as well as the market for corporate securities (that is, shares and debentures). However, this chapter is concerned exclusively with the latter usage.

The stock exchanges are the principal form of securities market. A stock exchange provides a market for the sale and purchase of corporate securities. Transactions upon the exchanges are effected by stockbrokers whose business is the sale or purchase of securities on the exchange, acting on an agency basis and charging a commission (or brokerage) generally varying with the size of the transaction. Until 1990 Australian stock exchanges provided a

physical marketplace – the trading floor – although some larger deals were effected off the trading floor. The trading floors were replaced in 1990 by a fully computerised trading system: see [11.40].

The second principal capital market is the so-called money market comprising the institutional networks which bring together lenders and borrowers of short-term funds. As with securities markets, money markets are not conducted through a physical marketplace but by the complex of dealings and trading relationships through which short-term debt claims are created and negotiated.

One important classification of capital markets refers to their primary and secondary functions. The primary function involves the transfer of funds from savers to borrowers who will use those funds for productive purposes. The issue of shares or debentures by corporations is an example, the new issue market for those securities being part of the securities market generally. The secondary function of a financial system is the provision of markets for trading claims or securities created at the primary stage. The principal example is the secondary market provided by the stock exchanges where stockbrokers trade in securities which have been admitted to quotation. The stock exchanges do not formally provide a market for new issues since subscriptions are not solicited on the exchanges. However, stockbrokers are centrally involved in the marketing of new securities issues to their clients and other potential subscribers.

While secondary markets do not contribute directly to capital formation, they provide essential support. First, they provide liquidity by enabling holders to convert securities into cash, ideally at minimum cost and without a significant decrease in price caused by the sale. The availability of liquidity is often an important inducement to investment. Secondly, secondary markets help to establish the cost of capital (or finance) for the issuer and the rate of return for the holder on the basis of information made available to the market and through the operation of forces of supply and demand. Thus, companies whose prospects are judged favourably by the secondary market will be able to raise finance more cheaply. The calculation of the opportunity costs of financing through retained earnings or depreciation charges is facilitated by knowledge of the returns expected by the market at certain prices.

Stock exchange listing and the quotation of securities

[9.15] Relatively few public companies will seek listing upon a stock exchange and obtain quotation for their securities: see [2.150]. However, this small group of companies generally contains the largest and most significant corporations and their listing and quotation represents the mature stage of the capital-raising process. The legal incidents of listing and the powers of the stock exchanges are examined below in Chapter 11. The present treatment of listing and quotation is therefore preliminary and for the limited purpose of understanding the role of the stock exchanges in capital accumulation for business enterprise.

The benefits and cost of listing

[9.20] Listing and quotation upon a securities exchange secures particular advantages. Four may be singled out. First, the company gains access to wider sources of finance through the new issue facilities of the securities markets. Stock exchange listing provides access to sources of equity capital and may liberate a company from reliance upon debt as a primary source of funding for its activities. The long-term character of equity and its freedom from any repayment obligation during the life of the company are transparent advantages. Further,

floating a company gives it access to a larger pool of equity capital than is generally available through private placement of its securities. Listing also facilitates the raising of additional capital through rights issues made to existing shareholders entitling them to subscribe for further quoted securities in proportion to their existing holdings. Rights issues are usually made at a slight discount to the market price of the security.[1] Secondly, listing secures liquidity for interests in the company, thus facilitating the raising of further capital. Thirdly, listing enables proprietors whose capital has been effectively locked up in their shareholdings to realise the value of their investment through sale upon a public market. Finally, listing generally conveys a reputational signal that may have advantages in dealings with financiers and suppliers.

Listing undoubtedly has its costs. The public market facility for the company's securities exposes its erstwhile controllers to the threat of an unwelcome takeover if they have used the listing to realise a significant portion of their holding. Listed companies also suffer a loss of privacy through their continuous exposure to the stock exchange, market and press inquiry as to price sensitive company developments. They are also subject to higher expenses – for listing fees, share registry, annual reports to shareholders and general investor relations.

The methods of listing

[9.25] The standard mode for the initial listing of a company and quotation of its securities is through a public offering made by means of a disclosure document lodged with ASIC under Ch 6D: see [10.55]. Quotation may also be granted to rights to subscribe for new capital and for that capital when it is issued upon exercise of those rights. A third method of listing, applicable both to an initial listing and the raising of additional capital, is by private placement made to institutional and other investors under exemption from lodgment of a disclosure document under Ch 6D. Before such a company is listed and its securities granted quotation, it would need to satisfy stock exchange criteria for admission which require disclosure broadly comparable to that required under Ch 6D.

The process of listing

[9.30] In the Introduction to its listing rules, the Australian Securities Exchange (ASX) reserves to itself an absolute discretion as to whether to admit a company to the list. The provisions of the listing rules governing admission of companies to the list embrace criteria touching both the financial condition of the company and the distribution of its securities among holders. The financial criteria are designed to minimise the risk associated with an investment and to provide investors with information necessary for its assessment; the minimum spread criteria are designed to provide holders with a reasonable expectation as to the liquidity of their investment in an orderly market. The specific admission criteria vary as between the several types of entity which may seek listing.

For companies seeking quotation for shares upon ASX, the financial criteria require proof either of a demonstrated record of trading profits from a continuing business activity or a minimum level of net tangible assets in respect of which the company has firm proposals for deployment or investment. If the company is an industrial company it must also provide

1 The rights issue may be expressed to be renounceable, that is, the shareholder may be entitled under the terms of issue of the rights to renounce in favour of another, her or his entitlement to subscribe for the securities at the rights price. Since this price is usually less than market value, the rights are themselves valuable and may be granted quotation along with the security to which they relate.

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independent expert opinion that it has sufficient working capital to meet its objectives and that its product, service or technology is sufficiently developed to provide a reasonable expectation of earnings within the next three years. The distributional criteria require at least a minimum number of shareholders each with a minimum shareholding value.

Under established practice, applicants for ASX listing are sponsored by a member of the exchange who will assume responsibility for organising listing and quotation, including the scrutiny of the draft prospectus by the ASX Listing Committee. If the securities offering is underwritten, the sponsoring broker assumes this role alone or in conjunction with an investment bank. Underwriting involves the performance of an insurance function in relation to an issue of securities. It is an important mechanism in the securities market in guaranteeing the capital sought to be raised against the vagaries of the market. It is closely allied to the process of marketing the securities.

There are different types of underwriting. The first is the classic or "old-fashioned" style of underwriting. This involves a contract whereby the underwriter, for a fee or commission, agrees to procure subscriptions for the securities and to subscribe itself for any not taken up. The company allots the securities directly to the subscriber. The underwriter commonly arranges for subunderwriters to accept responsibility for part of the issue on a similar basis, taking a subunderwriting fee which is below the underwriting commission. This is the most common type of underwriting arrangement in Australia. A second type is firm-commitment underwriting whereby the underwriter is allotted the whole issue and markets it by offering it for sale. In the United Kingdom and United States this is the dominant form of underwriting. A third type of underwriting is that in which the underwriter agrees to use its best efforts to place the securities. This involves no obligation to take up the shortfall, but is rather a selling agreement. It is often the best that a weak company can arrange and sometimes well-established companies are happy with this arrangement since, with the lower underwriting risk, the cost is proportionately reduced. Some underwriting agreements thought to be of the first variety, on close examination of the escape clauses, turn out to be closer to the third.

Apart from their insurance and marketing functions, underwriters are usually closely involved in the design of the flotation process and in the nurture of a healthy secondary market for the security after its issue, for example, by the preparation and dissemination of research material and the creation of institutional interest in the stock.

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Some principal sources of corporate finance

Short-term funding

[9.35] If short-term funding is defined as those sources of finance for a period of one year, it is clear that such funding is limited to debt rather than equity capital.[2] Debt funding takes several principal forms. Bank overdraft facilities are a major source of business finance,

2 For fuller treatments of both short- and long-term funding see Mallesons Stephen Jaques, *Australian Finance Law* (6th ed, 2008), Pt III; S R Bishop, H R Crapp & G J Twite, *Corporate Finance* (2nd ed, 1988), Chs 9 and 11; R Bruce et al (eds), *Handbook of Australian Corporate Finance* (3rd ed, 1989); E Carew, *Fast Money 3: The Financial Markets in Australia* (1991). The focus of this section is largely upon domestic sources. For valuable surveys of international capital markets, and the resort made to them by Australian users and providers of funds, see Bruce et al, Part D; M T Skully (ed), *International Corporate Finance* (1990); R Russell, "International Capital Markets: A Legal Survey" in Mallesons Stephen Jaques, *Australian Finance Law* (4th ed, 1999). For interesting biographies of some of the principal figures in the development of Australian capital markets see R Appleyard & C B Schedvin (eds), *Australian Financiers: Biographical Essays* (1988); see also R R Hirst & R H Wallace (eds), *The Australian Capital Market* (1974).

especially for small to medium businesses. Secondly, the unofficial money market provides distinct financing modes. Under the inter-company market, loans are made between companies of standing on an unsecured basis and for very short terms, often overnight or at 24 hours call. The commercial paper market permits the issue and negotiation of marketable short-term debt claims, commercial bills and promissory notes. A term of 90 to 180 days is common for commercial bills although the term of the bill may be renegotiated (or "rolled over"). The bill may be indorsed by a bank which thereby assumes a contingent liability as guarantor of repayment by the borrower. Promissory notes contain no such facility for third party indorsement and are essentially an extension of the inter-company money market.[3] Availability of this finance is therefore restricted to companies which enjoy substantial credit rating. A third source of short-term finance, employed by companies across the size spectrum, is the trade credit arising from the interval between the receipt of and the payment for supplies and services provided to a business. Trade credit often provides a very substantial portion of short-term finance.

Long-term funding

[9.40] One species of long-term corporate finance is, of course, equity capital, whether raised through an initial public offering, a private placement, a rights issue or under special schemes such as employee share schemes or dividend reinvestment schemes. Companies establish dividend reinvestment schemes to permit their shareholders to receive newly issued shares in lieu of a cash dividend. The shares are usually offered at a discount to the current market price of the share.

Long-term finance is also raised through the issue of debt claims. One species is the debenture or unsecured note, issued under a public offering process similar to public equity capital raising. A disclosure document is required under Pt 6D.2. Such debt issues may be underwritten. Term loans and mortgage loans, often assembled by an investment bank on behalf of a syndicate of potential lenders, provides a substantial source of finance for larger companies. Sophisticated variations upon this theme include project finance under which the financier has recourse only to the cash flow and assets of a particular project (such as a mining venture or large retail development) and complex leasing arrangements securing long-term finance.

Other securities issued by a corporation combine elements of both debt and equity capital. Preference shares more closely approximate debt in function and in some aspects of their legal treatment, although their legal classification remains as share capital: see [9.80]. Their particular advantage to the corporate issuer is the option which they confer to withhold dividend payments in periods of unprofitability without attracting the default remedies applicable to debt. Their issue also increases the equity base of the corporation and lowers its gearing.[4] The convertible note is a second popular hybrid. This is an unsecured note (or debt interest) issued upon terms which grant its holder the option to convert the debt claim into share capital. The conversion price and period for exercise of the option are usually specified

3 See Bishop, Crapp & Twite, p 271.

4 A company's gearing is the ratio of its debt to its equity capital. It indicates the extent to which creditors will be able to rely upon shareholders' contributions in the event of financial difficulty. A company is said to be "highly geared" when its debt is relatively large and its share capital relatively small. High gearing tends to concentrate the benefits for members when a company is doing well but, correspondingly, accentuates the risks for members (and creditors) when it is doing badly. What is regarded as appropriate gearing varies from

[12.235] *Takeovers Panel, Guidance Note 14: Funding Arrangements* 1022
[12.240] FRUSTRATING ACTION BY TARGET COMPANIES 1026
[12.245] *Re Pinnacle VRB Ltd (No 8)* 1027
[12.247] *Takeovers Panel, Guidance Note 12: Frustrating Action* 1037
[12.250] COMPULSORY ACQUISITION AND BUY-OUT OF MINORITIES 1040
[12.250] The scheme of compulsory acquisition and buy-out 1040
[12.255] Compulsory acquisition and buy-out following takeover bids 1040
[12.260] *Teh v Ramsay Centauri Pty Ltd* 1041
[12.275] General compulsory acquisition and buy-out powers 1045

THE CONTEXT OF TAKEOVER REGULATION

The several means of effecting transfers of corporate control

[12.05] In common parlance the word "takeover" refers to the process of gaining control of a company (the target) by bidding under a formal process for sufficient shares to achieve that end.[1] However, a takeover by formal offers for shares in the target company is but one way of acquiring control of a business and a variety of other means is available, particularly when the attempt is not contested or resisted. First, a common form of transfer for small business, is the purchase of assets, business and undertaking of the company – Australian corporate law does not recognise a doctrine of successor liability so that the purchaser may avoid being visited with unwanted liabilities provided that sufficient assets are left in the vendor corporation to avoid insolvency. However, stamp duty may be higher and there will be no carry forward of tax losses of the target, often a desired outcome.

Secondly, it is becoming increasingly common for takeovers to be effected by means of a scheme of arrangement under Pt 5.1, often coupled with a selective capital reduction: see [9.230]-[9.235]. Thus, shareholders in a target company might vote to approve a scheme that would see their shares transferred to the bidder, or cancelled so that only the bidder's shareholding remained, in either case for cash or a non-cash consideration, the latter often in the form of the bidder's own securities. The scheme process is within the control of the target and will only be instigated with the support of its board who will negotiate the terms of sale for shareholders to consider in general meeting. The shareholder consent thresholds for a scheme (75 per cent by value and 50 per cent by number (see [9.235])) are lower than those for the exercise of compulsory acquisition powers under takeover offers; the scheme mechanism also offers the certainty of either of two outcomes, acceptance or rejection, with no

1 See generally on takeover regulation I Renard & J G Santamaria, *Takeovers and Reconstructions in Australia* (Butterworths, looseleaf service); D D McDonough, *Annotated Mergers and Acquisitions Law of Australia* (3rd ed, Lawbook Co., 1999); H A J Ford, R P Austin & I M Ramsay, *Ford's Principles of Corporations Law* (13th ed, 2007), Ch 23; R Levy, *Takeovers: Law and Strategy* (LBC Information Services, 1996); for United Kingdom material on takeovers, see M A Weinberg, M V Blank & A L Greystoke, *Weinberg and Blank on Take-overs and Mergers* (5th ed, Sweet & Maxwell, 1989); R Finbow & N Parr, *UK Merger Control: Law and Practice* (Sweet & Maxwell, 1995); Sir Alexander Johnston, *The City Take-over Code* (Oxford UP, 1980). For valuable United States writing on takeover, their wider environment and issues, see J C Coffee, L Lowenstein & S Rose-Ackerman (eds), *Knights, Raiders and Targets: The Impact of the Hostile Takeover* (Oxford UP, New York, 1988); D C Bayne SJ, *The Philosophy of Corporate Control: A Treatise on the Law of Fiduciary Duty* (Loyola UP, Chicago, 1986).

unsatisfactory intermediate outcome.[2] However, the process is a less flexible one than a takeover so that a bidder using this process faces the risk of being outmanoeuvred if another bidder emerges to create an auction for the company. The scheme process is also more suited to a cool takeover market when target directors consider that an auction for control of their company is unlikely and that shareholders' interests are best served by their co-operating in the scheme process. In some cases control might also be transferred simply through a selective capital reduction, although in a company with a significant number of shareholders the binding effect of a scheme or compulsory acquisition will usually be necessary to achieve the control transfer.

Thirdly, a form of de facto control transfer may also be effected by the simple expedient of seeking control of the board through election of supportive directors using proxy solicitation for voting in general meeting. However, this form is rare, partly because of the benefits of board access to the proxy process and incumbency generally, the claims of rational shareholder apathy, and because of the feeling that control acquisition should be paid for, even that control which is not rooted in majority legal ownership.

The crucial issue in takeovers is corporate control. When the chosen means is the acquisition of shares, a holding of significantly less than 50 per cent may be sufficient; this may be so, for example, where the remaining shares are widely held by independent persons and the acquirer wishes to do no more than control the business operations of the target. On the other hand, if there are major interest groupings within the remaining shareholders, or if the acquirer intends to change the character of the target in some significant way as, for example, by integrating it with its other operations, nothing less than full ownership may be required. In such situations, there are other relevant measures of control, such as entitlement to or the enjoyment of:

- 75 per cent of the voting shares which ensures the ability to secure passage of a special resolution unless the holder is disenfranchised on a particular issue and subject always to oppression doctrines and other minority shareholder protection remedies;
- 50 per cent of the voting shares plus one which entitlement ensures the like ability to secure the passage of ordinary resolutions;
- such lesser shareholding as will be practically sufficient to secure passage of an ordinary resolution in a general meeting of members of the company in most circumstances (de facto control);
- boardroom control, where a majority of directors are prepared to act in accordance with the wishes of a particular shareholder or group; and
- control as measured by reference to a wider and more fluid standard through the capacity to determine the outcome of decisions about the financial and operating policies of the entity under, for example, accounting standards requiring consolidation of company financial statements: see [9.130].[3]

2 This degree of certainty may be very attractive also to the bid's financiers.
3 H A J Ford, R P Austin & I M Ramsay, *Ford's Principles of Corporations Law* (13th ed, 2007), para 23.050.

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Why do takeovers occur?

[12.10] What are the reasons for takeovers?[4] Why does a bidder pay a premium above market price for control of a company? Several reasons are often assigned. Takeovers permit the derivation of gains from superior management of target company assets: allocative efficiency gains are achieved if assets of a company are managed by those who can extract the greatest value from them; such managers will pay the highest price for those assets and the performance gains of this monitoring and acquisition are shared among shareholders of the target company and the bidder generally. This assumes constant monitoring of managerial performance of each company by managers of other companies; this disciplinary process, the market for corporate control, is asserted to be a significant accountability mechanism to ensure performance by managers: see [2.195]. However, there are major limitations upon its disciplinary effect: it is a blunt instrument since a bid for full ownership or control of a company simply to change its managers is a drastic measure, very expensive, difficult, and often belated.

A second explanation is in terms of the benefits to the bidder's managers in terms of increased power, status and prestige, and group size, with the latter perhaps working to inhibit a hostile bid for the company. A third explanation is in terms of the opportunistic gains to the bidder. Here it may be necessary to distinguish between what might be called looting (for example, a bid for less than full ownership of the company that is intended to be profitable through the oppression of minorities and the depletion of target assets through transfer to the bidder at an undervalue) and rational liquidation such as through a "bust up" takeover where the target is broken up and its assets disposed of. Such a step is not necessarily harmful to the economy although it is likely to be harmful to employees, suppliers and to the local communities in which the company operates or draws staff.[5]

The principles shaping Australian takeover regulation

[12.15] Takeovers are a significant feature of corporate life although the hostile takeover emerged only in the 1950s, initially in the United States. Since the 1960s the incidence of takeover activity in Australia has fluctuated between periods of hyperactivity and those of relative dormancy. This period has seen the progressive introduction of ever more detailed takeover regulation through legislation, now found in Chs 6, 6A, 6B and 6C of the Act (here called compendiously from time to time "the takeovers Chapters"). Its scope extends beyond transactions within the common idea of a takeover bid made for all the shares in a company to

4 See further on the causes and benefits of takeovers, R C Clark, *Corporate Law* (1986), pp 533-546; P Dodd, "Corporate control: what are the issues?" in *Takeovers and Corporate Control: Towards a New Regulatory Environment* (Centre for Independent Studies, 1987), pp 3-16; S Bishop, P Dodd & R R Officer, *Australian Takeovers: The Evidence 1972-1985* (Centre for Independent Studies, 1987); P Dodd & R R Officer, *Corporate Control, Economic Efficiency and Shareholder Justice* (Centre for Independent Studies, 1986); G A Jarrell, A Poulson & J Pound, "Regulating hostile takeover activity: an interpretive history of the US experience" in *Takeovers and Corporate Control: Towards a New Regulatory Environment* (Centre for Independent Studies, 1987), pp 19-36; O E Williamson, "Mergers, acquisitions and leveraged buyouts: an efficiency explanation" in L A Bebchuk (ed), *Corporate Law and Economic Analysis* (1990), ch 1; J C Coffee, L Lowenstein & S Rose-Ackerman (eds), *Knights, Raiders and Targets: The Impact of the Hostile Takeover* (1988), chs 11-17, 20-24; J C Coffee (1984) 84 Col L Rev 1145; J C Coffee, "Shareholders Versus Managers: The Strain in the Corporate Web" in J C Coffee, L Lowenstein & S Rose-Ackerman (eds), *Knights, Raiders and Targets: The Impact of the Hostile Takeover* (1988), pp 77-81 (see also pp 81-115 together with comments by V Brudney (pp 150-154) and M A Eisenberg (pp 155-158)).

5 See R C Clark, *Corporate Law* (1986), pp 533-546.

other acquisitions of interests in voting shares that are not intended to be part of a takeover bid. Further, there are other bodies of legislation that may affect the conduct of particular takeovers whether by reference to the character of the target,[6] of the bidder[7] or its anti-competitive effects.[8] The present focus, however, is upon corporate law aspects and those arising under the takeovers Chapters.

When the *Uniform Companies Act* was enacted in 1961 it included only two sections dealing directly with takeovers. Notorious avoidance of those sections led to the publication in 1969 of the Second Interim Report of the Company Law Advisory Committee (the Eggleston Committee), *Disclosure of Substantial Shareholding and Takeover Bids*. This report contained numerous proposals for reform that have continued to be highly influential in Australian takeover regulation. As a result, a so-called Takeover Code was introduced in 1971 with 25 new sections inserted into the Act. In the following three decades that legislation was regularly reviewed and was substantially recast under the CLERP process with effect from 2000. These changes did not, however, displace the principles adopted in 1969 by the Eggleston Committee on the policy objectives of takeover regulation (now known as the "Eggleston principles"):

> We agree with the general principle that if a natural person or corporation wishes to acquire control of a company by making a general offer to acquire all the shares, or a proportion sufficient to enable him to exercise voting control, limitation should be placed on his freedom of action so far as is necessary to ensure:
>
> (i) that his identity is known to the shareholders and directors;
>
> (ii) that the shareholders and directors have a reasonable time in which to consider the proposal;
>
> (iii) that the offeror is required to give such information as is necessary to enable the shareholders to form a judgment on the merits of the proposal and, in particular, where the offeror offers shares or interests in a corporation, that the kind of information which would ordinarily be provided in a prospectus is furnished to the offeree shareholders;
>
> (iv) that so far as is practicable, each shareholder should have an equal opportunity to participate in the benefits offered.[9]

These principles have had a profoundly shaping effect upon Australian takeover law, explicitly through their inclusion in the statement of the purposes of Ch 6, namely, to ensure that the acquisition of control over listed companies or those with more than 50 members takes place in an efficient, competitive and informed market and that conditions corresponding to the four Eggleston principles are satisfied whenever a person would acquire a substantial interest in the company: s 602.[10] They are also incorporated throughout the whole of the takeovers Chapters and particularly in the jurisdiction and powers of the Takeovers Panel (see [12.25]).

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

6 For example, under the *Broadcasting Services Act 1992* (Cth) (broadcasting and media companies) or the *Financial Sector (Shareholdings) Act 1998* (Cth) (banks and insurance companies).

7 *Foreign Acquisitions and Takeovers Act 1975* (Cth) (consent required for acquisitions by foreign interests).

8 *Competition and Consumer Act 2010* (Cth), s 50.

9 Company Law Advisory Committee, *Second Interim Report*, para 16.

10 An additional condition refers to an appropriate procedure being followed as a preliminary to compulsory acquisition of securities under Pt 6A.1 (see [12.255]).

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of allocative efficiency. At the base of most systems of takeover regulation is the question whether corporate control is treated as a corporate asset: do the transferors of a controlling block of shares owe fiduciary-type obligations to the company for the premium they receive? If not, what adjustments are to be made in the interests of the minority? Where, as in Australia, an equal opportunity to participate in transfer of control is accorded to all shareholders, the rationales are usually expressed in terms of:

- the danger of unfair treatment of minorities under a new controller;
- recognition of the opportunity for the purchaser of control to acquire the business at an undervalue, partly financed by the depression in the value of minority interests caused by the control transfer; and
- the right to participate in the sale of control as part of the investment expectation of all shareholders.

Arguments against the equality principle favour reliance upon market controls over legal regulation in view of the latter's assumed chilling (or stifling) effect on bids and the disciplinary effect of the market for corporate control – it is better for the pie to be bigger even if it is unequally divided.[11] The CLERP review of takeover regulation outlined the merits and costs of the fourth of the Eggleston principles – the equal opportunity to participate in the premium paid for control – in these terms:

> Without the equal opportunity principle, there could be differential treatment of shareholders. Control could pass without some shareholders having any opportunity to sell their shares at the likely higher price. In addition, the change in control could result in a reduction in the market value of the shares, depressing the price which minority shareholders could receive. A bidder could acquire control of all of the business and assets of the target at a price significantly less than the full value of the target. This would particularly be the case in a partial on-market bid where the bidder bought sufficient shares to deliver control in a short time period.
>
> The risk of becoming a minority shareholder unable to sell their shares at the pre-takeover price or receiving lower returns from a new purchaser of control may be able to be minimised through an investor diversifying their funds between different companies or assets. However, from an investor's perspective this would be a second best alternative to the equal opportunity principle as, in practical terms, diversification can be difficult to achieve without incurring substantial costs, especially if the investor does not have liquid investments. Alternatively, investors could move to managed investments, leading to less direct investment in the capital market.
>
> The equal opportunity principle potentially creates higher costs for market participants, reducing incentives to engage in takeover activity. ... Under the equal opportunity principle, the total consideration paid by the bidder could increase as a result of the need to make offers to all shareholders instead of those necessary to obtain control. Making the offer price sufficiently attractive to larger shareholders may also increase the total consideration paid. Alternatively, the principle could result in a lower premium obtainable by controlling shareholders, where the bidder decides to pay the same total premium and distribute it amongst all target shareholders.

11 Some also argue that the external costs generated by takeovers and borne by stakeholders (such as the loss of employment and the impact of plant closures upon local communities) are not adequately addressed by the shareholder-protective focus of corporate law. The rationales for and utility of takeover regulation are discussed further in R C Clark, *Corporate Law* (1986), pp 478-480, 491-498; J C Coffee (1985) 3 C & SLJ 216; Companies and Securities Law Review Committee, *Report on the Take-over Threshold* (1984), paras 73-113; Companies and Securities Law Review Committee, *Report to the Ministerial Council on Partial Take-over Bids* (1985); Companies and Securities Law Review Committee, *Partial Take-over Bids* (Discussion Paper No 2, 1985); D C Bayne SJ, *The Philosophy of Corporate Control: A Treatise on the Law of Fiduciary Duty* (Loyola UP, Chicago, 1986). As for the legal response to the coercive effect of takeover bids, see J C Coffee (1985) 3 C & SLJ 216 at 227-229.

Controlling shareholders in the target may consequently receive a smaller percentage of the premium than that reflecting the control inherent in a large shareholding. In this respect, the current law allows holders of smaller parcels of shares to gain a windfall, free-riding on the endeavours of controlling shareholders. However, it is likely that the effect of the equal opportunity principle is already taken into account by shareholders when acquiring control parcels.[12]

Although other regimes encourage equal treatment of shareholders to varying extents, Australian takeover law is distinctive, possibly unique, in the weight accorded to the equal opportunity principle. It is one of the cornerstone principles shaping Australian takeover regulation.

The structure of Australian takeover regulation

[12.20] The broad structure of Australian takeover regulation, sitting on top of the Eggleston principles, is comprised of the following principal elements:

- the takeover threshold of 20 per cent of voting shares (s 606(1); [12.50]) beyond which acquisitions are prohibited except by takeover offer (by either of two types, the *off-market bid* or *market bid*) or permitted exceptions ([12.130]); the takeover threshold is intended to stop persons short of the point where they may exercise de facto control of the company and require them to proceed across that threshold only in a manner that satisfies regulatory goals, usually by formal takeover bid;
- mandatory disclosure obligations in bids that are articulated to the prospectus standard of disclosure, at least where the consideration offered is in the form of corporate securities (s 636(1)(m); [12.195]);
- liabilities for misstatements are articulated with the regime applying under the fundraising and financial services provisions ([12.215]);
- Ch 6 applies also to the acquisition of interests in listed managed investment schemes;
- compulsory acquisition of minorities is permitted subject to safeguards (Ch 6A; [12.250]);
- the grant of remedial and other powers of the Court in relation to breaches of Ch 6 (ss 1325A – 1326));
- ASIC may exempt from and modify the takeover provisions (Pt 6.10 Div 1);
- since 2000 a central role has been assigned to the Takeovers Panel (Pt 6.10 Div 2) including
  - the power to declare unacceptable circumstances: the provision enjoins respect for the spirit as well as letter of the Eggleston principles and
  - the ouster of tactical litigation in favour of the Panel playing an almost exclusive role in takeover dispute resolution; and
- mandatory disclosure of information concerning the acquisition of substantial shareholdings[13] in and the tracing of beneficial ownership of listed companies (Ch 6C; [12.220]).

12 *Takeovers: Corporate control: a better environment for productive investment* (Corporate Law Economic Reform Program Proposals for Reform: Paper No 4, 1997), pp 14-16; see also J Mayanja (2000) 12 Aust J Corp L 1; J Mannolini (1996) 14 C & SLJ 441.

13 Defined as 5 per cent of voting shares (s 9); changes in the entitlements of substantial shareholders must be reported on a timely basis in the interests of an informed market for the securities.

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