Should Directors be Allowed to Use Takeover Defensive Measures?

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Abstract

There are three views on the issue of whether target directors should be allowed to use takeover defensive measures. The first view, which advocates a passive role for the directors when faced with a takeover bid, opposes the use of defensive measures. It does so not only because the takeover situation involves a conflict of interest for the target directors, but also because the use of defensive tactics hinders shareholder wealth maximisation.

The second view would also curtail the power of the target directors to use defensive measures, except to the extent that competitive bidding is achieved. An auctioneering role for the target directors is favoured because of the efficiency-inducing effect of price competition. A rule of auctioneering also solves the problem of coercion associated with partial bids.

The third view defends the current policy of allowing directors to use defensive measures, subject to compliance with their fiduciary duties. According to this view, defensive measures not only benefit the target shareholders, but are also needed to enable the directors to promote the long-term interests of the company and to protect the welfare of non-investor constituencies.

Because the Australian evidence on the matter would seem to give support to the first two views, there is a serious need to review the present policy of allowing directors to use takeover defensive measures.

Introduction

The singular corporate activity which has caught the public attention in the past decade has been takeovers. An important aspect of takeovers concerns the power of the directors of the target company to resist the takeover. Takeover defences play a significant role in the outcome of the takeover bid.[1] It has been found, for instance, that takeover bids which are resisted have a high probability of failure.[2]

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1 Eddey, PH and Casey, RS, "Directors' Recommendations in Response to Takeover Bids: Do They Act in Their Own Interests?" (1989) 14 *Australian Journal of Management* 1.

2 The failure rate of takeover bids where the target directors defended the target Australian listed company was at least 70% between 1971 and 1985: Casey, RS and Eddey, PH, "Defence Strategies of Listed Companies Under the Takeover Code" (1986) 11 *Australian Journal of Management* 153.

Under Australian law, directors have the power to utilise defensive measures subject to certain statutory duties[3] and to their general common law duties, including the duties of care, diligence and skill, the obligation to avoid a conflict of interest and the duty to act *bona fide* for the benefit of the company as a whole. The last mentioned duty is considered the most relevant in a takeover scenario and has, in fact, received considerable judicial attention.[4] The test which the courts have developed in determining whether there has been compliance with the relevant duty is the proper purpose test. According to this test directors are bound to exercise corporate powers only for a proper purpose.[5]

The discussion in Australia concerning defensive measures, limited as it is, has largely been confined to examining the scope, nature and adequacy of the proper purpose test, searching for alternative tests and generally dealing with the standards by which to determine the propriety of the decision of the directors of the target company to use defensive measures.[6] The underlying assumption is that the target directors should be allowed to resist a takeover bid. There is, however, a more fundamental issue which is, whether the target directors should be allowed to use defensive measures in the first place.

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3 See, for example, ss 231, 232, 699 and 648 of the Corporations Law.

4 The nature and basis of this duty was expressed in *Mills v Mills* (1938) 60 CLR 150 at 185-186, thus: "Directors of a company are fiduciary agents, and a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to a power. It is only one application of the general doctrine expressed by Lord Northington in *Aleyn v Belchier* (1758) 1 Eden 132 at 138, 28 ER 634 at 637: 'No point is better established than that, a person having a power must execute it *bona fide* for the end designed, otherwise it is corrupt and void.'"

5 See *Australian Metropolitan Life Insurance Co Ltd v Ure* (1923) 33 CLR 199; *Ngurli Ltd v McCann* (1953) 90 CLR 425; *Harlowes Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co NL* (1968) 121 CLR 483; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Winthrop Investments Ltd v Winns Ltd* (1974) 4 ACLR 1; *Pine Vale Investments Ltd v McDonnell & East Ltd* (1983) 8 ACLR 199; *Contraulics Pty Ltd v Barry & Roberts Ltd* (1984) 2 ACLC 408; *Hogg v Cramphorn Ltd* [1987] Ch 254; *Advance Bank Australia Ltd v FAI Insurance Ltd* (1987) 9 NSWLR 464; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 5 ACLC 421; *Darvall v North Sydney Brick & Tile Co Ltd & Ors* (1989) 15 ACLR 230.

6 See, for example, Baxt, R, "Second Guessing Directors' Decision on Takeovers - A Mixed Message from the New South Wales Court of Appeal" 8 *Company and Securities Law Journal* 26 (1990); Black, A, "Recent Developments in Directors' Duties" (1991) 8 *Australian Bar Review* 10; Steel, T, "Defensive Tactics in Company Takeovers" 4 *Company and Securities Law Journal* 30 (1986); Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors*, Canberra, AGPS, 1989.

In the United States ("US"), where takeover activity is massive, there is a growing body of literature which opposes the largely wide power of target directors to resist takeovers. This school of thought posits that maximisation of shareholder wealth is the appropriate criterion for evaluating takeovers and target management defensive measures. This is because, first, directors are required to act for the benefit of the company as a whole (which has been defined to mean the body of shareholders), and secondly, shareholder wealth maximisation is seen either as leading to, or as the best proxy for, social wealth maximisation. On the evidence that takeovers increase shareholder wealth, it is contended that management has only two options for responding to a takeover bid: (a) passivity; and (b) instigation of an auction.

The other body of opinion would permit defensive tactics because they may have the result of procuring a better price for the shares and thus fulfill the shareholder wealth maximisation function. Moreover, the protection of the interests of non-investors is an additional criterion for evaluating takeovers which the first view does not consider and which is a further argument for allowing defensive tactics.

This paper is a brief survey of the different views involved in the policy debate about the use of defensive measures by the target directors. Also included is a summary of empirical studies made in Australia relevant to the issue. It is hoped that this exposition will generate more discussion on the matter.

Towards Restricting the Target Directors' Power to Use Defensive Measures against Takeover Bids

The school of thought which advocates the curtailment of the target directors' power to use defensive measures may be divided into two groups. The first, by advocating a prohibition against all defensive measures, would give a purely passive role to the target directors when faced with a takeover bid. The second school of thought shares most of the premises on which the first group is anchored but, for reasons discussed below, rejects a totally passive role for directors, allowing them the authority to put up resistance that triggers a bidding contest.

The first argument against allowing defensive tactics is that the takeover situation poses a conflict of interest for directors. Very often, the directors' positions are on the line should a takeover bid be successful. In Australia, for example, a study of 99 takeovers showed that in 20.2% of successful takeovers, the board of directors was

completely replaced immediately after the takeover, with a partial change occurring in 49.6%.[7]

Robert C Clark explains succinctly the extremely difficult situation which directors face when their company is the target of a takeover bid. He states:[8]

> Indeed, we could well conclude that *in no other context is the conflict of interest as serious as in the takeover situation.* Often the managers' jobs are at stake. The temptation to find that what is best for oneself is also best for the corporation and shareholders (for example, to assert that the company's stock is "undervalued" and that shareholders will eventually do better if the pending offer fails), the temptation to spend corporate resources extravagantly in the attempt to fend off the raider (it's always easier to spend other people's money), and the temptation to sacrifice the shareholders' interests (as by paying exorbitant amounts of greenmail) must be overwhelming. No human being can be expected to resist such temptations. Nor does it matter much if a majority of directors are outside directors. They still have a social bond with the inside directors and officers, not with the diffuse public shareholders, and they may care about the status and perquisites that go along with being a director.

The traditional legal doctrines currently in use - the business judgment rule,[9] the primary purpose test[10] and the intrinsic fairness test[11] in the US and, by analogy, the proper purpose test[12] in Australia

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7 Hubbard, GL, "Targeting the Takeover" (1987) 39 *Professional Administrator* 13.

8 Clark, RC, *Corporate Law*, Boston, Brown Little, 1986, at 588 (emphasis in the original).

9 According to this rule, "[a] board of directors enjoys a presumption of sound business judgment and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment" (*Sinclair Oil Corp v Levien* 280 A 2d 717, 720 (1971)). See also *Smith v Van Gorkom* 488 A 2d 858 (1985); *Doyle v Union Ins Co* 277 NW 2d 36 (1979); *Pogotsin v Rice* 480 A 2d 619 (1984); *Unocal Corp v Mesa Petroleum Co* 493 A 2d 946 (1985); *Airline Pilots Association, International v UAL Corp, et al* 717 F Supp 575 (1989).

10 Under this test, courts inquire whether the directors were acting for a proper business purpose or primarily seeking to perpetuate themselves in office. "[W]here a good corporate purpose is being furthered and is the principal motivation for an action by a board of directors, the fact that the consummation for such transaction may have some effect on the control of the corporation is immaterial and the agreement will stand or fall depending on whether it is fair to the corporation" (*Cummings v United Artists Theatre Circuit* 204 A 2d 795, 806 (1964)). See also *Treadway Companies, Inc v Care Corporation* 638 F 2d 357 (2nd Cir 1980); *RCM Securities Fund Inc v Stanton, et al* 928 F 2d 1318 (2nd Cir 1991).

11 This rule applies where a director has a material personal interest in the outcome of a transaction or is engaged in self-dealing and, in contrast to

- are looked upon with disfavour by the passivists who regard these tests as neither meaningful nor administrable.[13] It is claimed that these legal rules have only spawned confusion and, in the final analysis, are indeterminate because it is difficult if not outright impossible to distinguish between cases where directors are acting in the best interests of the corporation or shareholders from cases where such assertions are merely a ploy.

The other and more important argument against defensive measures is based on economics. According to the efficient capital market theory,[14] prices fully reflect the value of the firm. The rate of return investors receive provides a measure of how resources in the company are being utilised. A series of abnormally low returns could signal to potential takeover bidders that resources are being used inefficiently. Takeovers are therefore mechanisms for transferring inefficiently utilised assets to those who can use them more efficiently.[15]

A corollary to the efficient market theory is the theory of a market for corporate control, which, according to Easterbrook and Fischel[16] (the main proponents of the pure passivity doctrine), is the most probable explanation for hostile takeovers. The theory states that:[17]

> a decrease in corporate profits, whether because of inefficient management or because of efficient but self-dealing management

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the business judgment rule where the burden of proof lies with the person challenging the directorial decision, the intrinsic fairness rule puts it to the director to prove that the transaction he or she authorised is intrinsically fair to the corporation and its stockholders: see *Gans v Marlowe Pen Co* 250 NE 2d 811 (1969); *Trans World Airlines Inc v Summa Corp* 374 A 2d 5 (1977); *Weinberger v UOP Inc, et al* 457 A 2d 701 (1983).

12 See footnote 5.

13 Easterbrook, FH and Fischel, DR, "The Proper Role of a Target's Management in Responding to a Tender Offer" 94 *Harvard Law Review* 1161, at 1202-3 (1981) (hereafter "Easterbrook and Fischel"); Gilson, RJ, "A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers" 33 *Stanford Law Review* 819, at 821-31 (1981) .

14 See Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work" 25 *The Journal of Finance* 383 (1970); Note, "The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industries" 29 *Stanford Law Review* 1031 (1977) ; Bever, "Market Efficiency" 56 *Accounting Review* 23 (1981) .

15 For empirical support for this hypothesis, see Kummer, DR and Hoffmeister, JR, "Valuation Consequences of Cash Tender Offers" 3 *The Journal of Finance* 505 (1978) .

16 Easterbrook and Fischel, at 1161.

17 Gilson, RJ, work cited at footnote 13, at 841-2. For an analysis of empirical studies on the theory of the market for corporate control, see Gilson, RJ, *The Law of Corporate Acquisitions*, New York, The Foundation Press Inc, 1986, at 377-83.

> has diverted too much income to itself, causes the price of the corporation's stock to decline to a level consistent with the corporation's reduced profitability. This creates an opportunity for entrepreneurial profit. If shares representing control can be purchased at a price which, together with the associated transaction costs, is less than the shares' value following displacement of existing management, then everyone - other than the management to be displaced - benefits from the transaction. Selling shareholders receive more for their stock than its value under previous management; new management receives an entrepreneurial reward through the increased value of acquired shares; the society benefits from more efficiently used resources.

In addition to the abovementioned benefits to the target shareholders[18] and bidder, shareholders in general benefit even if their company never becomes the subject of a takeover bid.[19] The monitoring process poses a continuous threat of takeover if performance is wanting. In order to reduce the chance of a takeover, management, including directors, must constantly ensure that the company is run efficiently, a process which leads to higher prices for shares.[20]

The economic argument presented so far establishes that takeovers benefit both shareholders and society. From this, the advocates of the passivity rule assert that "any strategy designed to prevent tender offers reduces welfare" because "the shareholders lose whatever premium market value the bidder offered or would have offered but for the resistance or the prospect of resistance".[21] Easterbrook and Jarrell, for example, after examining the evidence from financial economics, concluded that successful defensive tactics deprive target shareholders of appreciation gains of between 15% to 52% of the value of target shares.[22] This lost premium also results in a wasted general economic gain from a more efficient utilisation of the firm's assets.[23] Easterbrook and Fischel maintain that even defensive measures which elicit a higher premium are socially wasteful.[24] The process of resistance consumes resources and shareholders, as a whole, lose by the amount the target directors

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18 For empirical evidence regarding a takeover's economic benefits to shareholders of a target company, see Dodd, P, "Merge Proposals, Management Discretion and Stockholder Wealth" 8 *Journal of Financial Economics* 105 (1980); Dodd, P and Ruback, R, "Tender Offers and Stockholder Returns: An Empirical Analysis" 5 *Journal of Financial Economics* 351 (1977).

19 Easterbrook and Fischel, at 1174.

20 Easterbrook and Fischel, at 1174.

21 Easterbrook and Fischel, at 1174-5.

22 Easterbrook, FH and Jarrell, GA, "Do Targets Gain from Defeating Tender Offers?" 59 *New York University Law Review* 277 (1984).

23 Easterbrook and Fischel, at 1175.

24 Easterbrook and Fischel, at 1175.

spend in putting up defensive measures, plus the amount the takeover bidders spend to overcome the resistance.[25] More significantly, it is argued that the initial bidders incur substantial search costs in identifying good targets and subsequent bidders take a free ride on the first bidder's search efforts. As a result, no firm wants to be the initial bidder and "if there is no first bidder there will be no later bidders and no tender premium".[26] Hence, a policy of allowing directors to auction the company cannot be allowed because it will have the long-term effect of discouraging takeovers and impeding their beneficial effects.

Towards Facilitating Competitive Bidding

The modified passivity view would also prohibit the power of the target directors from using defensive measures, except those which would result in competitive bidding. A rule of auctioneering increases premiums paid to the target shareholders.[27]

The advocates of the modified passivity rule acknowledge that the first bidder incurs some costs in the search for target companies, but assert that such costs are not substantial and are only a small proportion of the purchase price.[28] Moreover, the initial bidder who does the search receives several benefits. First, the initial bidder has the advantage of time. The period for making the competing bids is limited and the first bidder will have an informational advantage over other potential buyers, provided the latter are not given information by the target management.[29] Secondly, the risk that the initial bidder will lose the takeover to a higher bidder can be hedged by taking a substantial block position in the stock of the target company before the initial bidder announces its intentions. If the initial bidder is outbid, it will simply tender its target shares to its competitor or to the market at a profit.[30] Hence, whether the searcher wins or loses an auction, it will earn a gain on its pre-offer purchase of the target company's shares.[31] Because of these incentives to search, the free rider argument against auctioneering and its discouraging effect on takeovers is dismissed by the modified pacifists as unpersuasive. They insist that auctioneering should be allowed for a number of reasons, in addition to the fact that such a process raises the premium paid to the target shareholders.

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25 Easterbrook and Fischel, at 1175.

26 Easterbrook and Fischel, at 1179.

27 Bebchuck, LA, "The Case for Facilitating Tender Offers" 95 *Harvard Law Review* 1028, at 1045 (1982) (hereafter "Bebchuck").

28 Gilson, RJ, work cited at footnote 13, at 870-1.

29 Bebchuck, at 1036.

30 Gilson, RJ, work cited at footnote 13, at 871.

31 Bebchuck, at 1035.

There are two significant arguments which the modified pacifists claim.

The first argument is the efficiency-inducing effect of price competition. According to Gilson, "allocating resources among competing claimants by price is desirable because it places resources with the most efficient users".[32] The potential bidders do not have identical resources nor do their management possess the same skills. Price competition through a rule of auctioneering ensures that the target company is allocated to the bidder which has the best capacity to use the target resources efficiently.[33]

The second important argument in favour of a rule of auctioneering is that it solves the problem of coercion associated with partial bids. According to the so-called problem of coercion in partial bids, dispersed target shareholders who face only one potential buyer are unable to organise and threaten to block the takeover, even if faced with the prospect of being made worse off because of any of the following factors which may result from a successful takeover:[34]

> (1) their remaining shares have been shorn of their control premium once the bidder assembled a majority block;
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> (2) the bidder may have the practical ability to exploit or oppress the minority shareholders ...; or
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> (3) the minority shareholders face the prospect of illiquidity if the company will be delisted from the ... Stock Exchanges because the stock no longer satisfies their criteria.

Hence, each target shareholder must make a choice between an offered price which is unsatisfactory and the threat of the abovementioned factors. As Coffee stated, "[t]he heart of the dilemma is that, because no shareholder can rely on what other shareholders will do, they cannot coordinate their actions in order to reject the unsatisfactory offer and negotiate for a higher price".[35] One of the solutions to the problem of coercion[36] is to allow directors to solicit competing bids. Such a rule would not only give the directors a better bargaining position in relation to the takeover bidders but, more importantly, the existence of competing bids or the threat of

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32 Gilson, RJ, work cited at footnote 13, at 872.

33 See footnote 32.

34 Coffee Jr, JC, "Partial Justice: Balancing Fairness and Efficiency in the Context of Partial Takeover Offers" 3 *Company and Securities Law Journal* 216, at 227 (1985).

35 See footnote 34.

36 For other possible solutions to the problem of coercion in partial bids, see Coffee, Jr, work cited at footnote 34, at 216; see also Clark, RC, work cited at footnote 8, at 588.

them will force each bidder to offer a premium which is closer to the real value of the target shares and which reflect the bidder's capacity efficiently to use the target company's resource.[37]

Maintaining the Status Quo: Allowing Directors to Use Defensive Measures

The current policy of allowing directors to use defensive measures, subject to their compliance with their fiduciary duties, is not without defenders. The advocates of this policy are able to muster evidence which contradicts the economic arguments of the pacifists. Lipton, for example, found that the shares of more than 50% of the target companies which defeated hostile takeovers had a higher market price than the offer price, after the successful defence.[38] Dodd and Ruback's study indicated that the target firm's stockholders earn positive returns even for unsuccessful takeover offers.[39] More recently, Berkovitch and Khanna found that certain defensive strategies, such as crown jewel sales, lock-up options, litigation, or purchase of assets which make the target company undesirable for bidders, do improve the target shareholder's wealth.[40]

Besides the economic benefits flowing to the shareholders as a result of the defeat of a takeover bid, it is argued that the power to employ defensive measures is necessary to enable the directors to make long-term plans.[41] To impose an obligation on directors to sell whenever a substantial premium is available, is to be short-sighted. If the directors believe that the company could be sold in the future for a larger premium, or that the future market value plus the interim dividends have a greater value to the shareholders than the present offer price, the directors must be given the power to reject the offer to achieve long-term benefits.[42] It is also suggested that the directors have a duty not only to the shareholders but also to non-investors and to the community in general. Requiring the acceptance of any takeover bid would have an unsettling impact on non-investor constituencies, including employees, customers, suppliers and creditors who would be deprived of the assurance of continuity.[43]

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37 Bebchuck, at 1039-41, 1044-6.

38 Lipton, M, "Takeover Bids in the Target's Boardroom" 35 *Business Lawyer* 101 (1979) .

39 Dodd, P and Ruback, R, work cited at footnote 18, at 351.

40 Berkovitch, E and Khanna, N, "How Target Shareholders Benefit from Value-Reducing Defensive Strategies in Takeovers" 45 *The Journal of Finance* 137 (1990).

41 Lipton, M, work cited at footnote 38, at 109.

42 Lipton, at 109.

43 Lipton, at 110. Under Australian law, directors may consider the interest of the company's creditors: *Walker v Wimborne* (1976) 3 ACLR

The power of directors to use defensive measures can be used to promote business stability and long-term planning to the economy in general.[44]

The proponents of the active resistance view seem sceptical about the merits of takeovers[45] and the efficient capital market hypothesis.[46] Takeovers are regarded as vehicles for empire-building by large companies.[47] Takeovers may harm competition in certain industries, concentrating market power, thus giving the merged firms the power to increase price or decrease output, and ultimately harming consumers.[48] Lastly, it is claimed that the takeover phenomenon diverts investment resources from more socially productive uses[49] and, in the final analysis, does not enhance overall economic wealth.[50]

The Australian Experience

Notwithstanding the prominent public attention given to the takeover phenomenon, studies have been few and far between in Australia. In one of the earliest empirical studies on takeovers and the Australian equity market, Dodd[51] found, after examining a sample of takeover offers for public companies on the Sydney Stock Exchange between 1960 and 1970, that, on average, the target shareholders experienced significant wealth increases around the date of the takeover offer.

529; *Jeffree v NCSC* (1989) 15 ACLR 217; 7 ACLC 556, but those of the employees may only be considered in a very limited extent: *Parke v Daily News, Ltd* [1962] 2 All ER 929. See Baxt, R, "A Senior Australian Court Gives the 'Thumbs Up' to the Winkworth Principle - Directors Owe a Duty to Creditors Both Present and Future" 7 *Company and Securities Law Journal* 344 (1989); Black, A, work cited at footnote 6, at 28-9.

44 Lipton, at 110.

45 Lipton, M, "Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel" 55 *New York University Law Review* 1231 (1980) .

46 Harrington, WD, "If It Ain't Broke, Don't Fix It: The Legal Propriety of Defences Against Hostile Takeover Bids" 34 *Syracus Law Review* 977, at 1008-11 (1983) .

47 Lipton, M, work cited at footnote 45, at 1232-3.

48 Braby, R, "Company Takeovers - An Alternative View" (1988) 58 *Australian Accountant* 56.

49 Williams, H, "Tender Offers and the Corporate Director" [1979-1980 Transfer Binder] *Federal Securities Law Reporter* (CCH), paragraph 82, 445, paragraph 82, 877.

50 See Mueller, DC, *The Determinants and Effects of Mergers*, Massachusetts, Oebgeschlager, Gunn & Hain, 1983.

51 Dodd, P, "Company Takeovers and the Australian Equity Market" (1976) 1 *Australian Journal of Management* 15.

Subsequently, in a study of 572 takeover bids involving Australian listed companies between 1 January 1966 and 31 December 1972, Walter[52] found that the target shareholders, after experiencing a period of average or below average investment performance, enjoyed excess positive returns during the 20 weeks leading to and including the takeover announcement week. Most of the gains accrued during the announcement week. The study confirmed the following hypotheses that:

(1) when information inherent in a takeover announcement becomes publicly available, share prices instantaneously adjust; and

(2) takeovers are undertaken in a market for corporate control in which unique resources of the targets are auctioned among competing bidders.

The work of Bishop, Dodd and Officer,[53] which covered the period January 1972 through to June 1985, yielded results consistent with Walter's study. It was found, among other things, that:

(1) the target shareholders earned an average 20% positive abnormal return in the six-month period prior to and including the month of the offer announcement;

(2) the target shareholders earned economic gains regardless of the result of the takeover;

(3) takeover offers were usually made after the bidding firm experienced abnormally high returns in the previous 36 months;

(4) the announcement of an offer was associated with increases in the share prices of the bidding firm and its shareholders' benefit from the proposed acquisitions; and

(5) the total value created by takeover offers, measured by the change in the residual values of the outstanding shares of the bidding and target firms involved in the study, was $7.2 billion.

The authors of the study concluded, among other things, that because the evidence yielded from the study points to large increases in shareholder wealth as a result of takeover offers, there must be an enhancement of incentives to takeovers since a restriction of the level or frequency of takeovers will be harmful to the Australian economy.

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52 Walter, TS, "Australian Takeover: Capital Market Efficiency and Shareholder Risk and Return" (1984) 9 *Australian Journal of Management* 63.

53 Bishop, S, Dodd, P and Officer, RR, *The Australian Takeovers: The Evidence 1972-1985*, St Leonards NSW, The Centre for Independent Studies, 1987.

Brown and Horin[54] provided further evidence of the competitiveness of the Australian corporate acquisitions market. Instead of measuring the existence and degree of competition in the market for corporate acquisitions by the abnormal share price changes of firms that bid successfully or by the changes in the market value of the target firms or by the gains shared between the shareholders of the target and bidding firms, Brown and Horin utilised Ruback's[55] test which is that "the market would be competitive if, in the context of two of more bidders, it did not pay an unsuccessful offeror to lift his bid to the successful offeror's price".[56] This is so because "in a competitive market, a rational offeror will not raise his bid above the price where the corporate acquisition has a zero net present value".[57] Hence, the takeover market would be competitive if "the successful offer price exhausts the potential gains for all unsuccessful bidders".[58] The results of the study showed that the Australian takeover market is competitive, with 58 of the 72 takeovers in the study being consistent with the definition of a competitive takeover market adopted by the authors.

The studies so far summarised give empirical support to the efficient market theory as well as demonstrate the value-increasing effects of takeovers. The results of these Australian studies mirror the US evidence on which the proponents of the passivity view rely. It must be noted, though, that these studies have not specifically dealt with defensive measures. Empirical proof showing the detrimental effects to the shareholders and the economy of defensive measures, in the Australian context, has yet to be presented. On the contrary, in one of the very few Australian studies specifically dealing with directors' actions in relation to takeover bids, Eddey and Casey found that the target directors' decision to reject a takeover offer does not prejudice the target shareholders' interest.[59] Overall, it was found that directors, in the takeover situation, have acted to protect shareholder interests.

In an earlier study also dealing with defensive measures, the National Companies and Securities Commission found that such measures are not detrimental to the target shareholders because "in defended takeovers, shareholders realise a significantly higher

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54 Brown, P and Horin, A, "Assessing Competition in the Market for Corporate Control: Australian Evidence" (1986) 11 *Australian Journal of Management* 23 (hereafter "Brown and Horin").

55 Ruback, RS, "Assessing Competition in the Market for Corporate Acquisitions" 11 *Journal of Financial Economics* 141 (1983).

56 Brown and Horin, at 24.

57 Brown and Horin, at 27.

58 Brown and Horin, at 27.

59 Eddey and Casey, work cited at footnote 1.

premium than they do in takeovers where the board of the target does not resist".[60] The Commission noted that when the defensive tactic is successful,[61] the target shareholders lose the premium, but only temporarily, since the target company is likely to face another takeover bid soon after. The Commission took a favourable view of defensive tactics but only to the extent that they resulted in higher premiums, either from the original bidder or from competing bidders. Its position was therefore akin to the modified passivists in the US.

Conclusion

The importance of defensive measures should, by now, be evident. However, the full implications of their use by the target directors in the Australian context have not yet received adequate scrutiny. Given the increasing likelihood that the target directors will defend the company against a takeover bid,[62] it is imperative that the discussions on takeover defences be broadened beyond the search for the appropriate doctrinal limitations on their use. There is a need to pursue more vigorously the policy debate on whether directors should be given the power to use defensive measures. Most of the Australian evidence seems to lend support to the view which is opposed to the present policy of allowing directors to use defensive measures subject to certain limitations. While not conclusive, this body of evidence should at least serve as a catalyst for a policy review on the matter.

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60 National Companies and Securities Commission, *Defensive Schemes and the Duties of Directors: A Discussion Paper Submitted to the Ministerial Council for Companies and Securities on 26 September 1986*, 1986, at 7.

61 The Commission found that the success rate of defence tactics was 74% in 1985 and 51% in 1984.

62 The ratio of defended bids to total bids for Australian companies averaged 9.3% between 1975 and 1980 but has increased to 24% between 1981 and 1985: Casey, RS and Eddey, PH, work cited at footnote 2.