ACQUISITION OPPORTUNITIES FOR AUSTRALIAN COMPANIES IN THE U.S.

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INTRODUCTION

Corporate acquisition have become one of the more significant methods of business expansion in the U.S. In large part this reflects a growing perception that for many companies it will prove quicker and cheaper to undertake significant growth by acquiring an existing business rather than commencing operations anew.

Foreign enterprises have long recognized the acquisition opportunities in the U.S. Perhaps the best known Australian examples to date are C.S.R.'s acquisition of Delhi International Oil in 1981, B.H.P.'s acquisition of Utah International in 1984, Industrial Equity Limited's acquisition of The Higbee Company in 1984, and, most recently, Rupert Murdoch's 1985 purchases of the Twentieth Century Fox movie and TV studio and his pending acquisition of six of Metromedia's big-city independent television stations.

There is every indication that the trend of increased foreign investment in the U.S. will continue. The breadth and diversity of the U.S. economy and the relative stability of the U.S. dollar should provide a wide range of attractive investment opportunities. The enormous depth of the U.S. capital markets and their receptiveness to foreign securities and innovative financing techniques permit substantial amounts to be raised as acquisition capital either before or after the acquisition is consummated.

Moreover, with the exception of reporting requirements applicable to certain types of foreign direct investment and of the special restrictions imposed with respect to so-called "regulated industries", there is no general regulation of foreign investment in the U.S. By and large, foreign acquirors are treated very much like domestic acquirors and have the same freedom as domestic enterprises to buy U.S. businesses.

This article discusses the principal acquisition structures employed by U.S. and foreign acquirors and provides a brief overview of the applicable legal framework.

STRUCTURING AN ACQUISITION

There are a large variety of possible structures by means of which all or portion of the shares or assets of a U.S. company may be acquired by an Australian investor. Not all have parallels in Australia. Selection of the structure most appropriate to effect the business purposes of a particular investor involves consideration of a broad spectrum of issues ranging from purely legal issues to business and accounting questions. Professional advice from U.S. investment bankers, lawyers, accountants and others will generally be of considerable assistance in this process. Set forth below is a brief outline of some of the more important acquisition forms.

1. Share Purchases

Generally, sizable share acquisitions of widely held U.S. public companies are effected by "tender offer" (a takeover offer in Australian parlance). A tender offer is made directory to the shareholders of the target to purchase all, or a specified maximum number of the target's shares at a specified price and subject to specified conditions. The offer may be "friendly", involving a negotiated transaction approved in advance by the target's board with the price, terms and structure agreed upon. By contrast, in a unilateral or "hostile" offer, the friendly exchange of ideas between the managements of the participating companies is conspicuously absent, with the target's management opposing the acquisition. "Friendly" and "hostile" acquisitions are at opposite ends of the same spectrum with many transactions involving elements of both. Thus, for example, a so-called "bear hug" letter is an unsolicited approach to target management which has as its objective encouraging management, perhaps as a result of shareholder pressure when the offer becomes public, to enter into a "friendly" transaction.

In a tender offer, target shareholders are offered either cash or securities in exchange for their shares. Of these two forms, securities are used with much less frequency than cash. The principal reason for this is the federal registration and disclosure requirements attending the issue of the exchange securities. The consequent delay and disclosures concerning the acquiror afford much greater opportunities for target management to take defensive action. From time to time, proposals have been made to place exchanges of securities on an equal footing to cash in terms of disclosure obligations.

A tender offer is often followed up by a merger once the acquiror has achieved a control position in the target. Mergers, which are a uniquely American phenomenon, are discussed in more detail below. The purpose of the second stage merger is to eliminate remaining target shareolders who did not tender their shares. As a result of the merger the target will generally become a wholly-owned subsidiary of the acquiror. There is greater scope for the use of securities as part of the consideration for such a second stage (or "back end") merger since the acquiror will have already achieved its control position and is likely to be less concerned with delays and disclosure obligations at this stage. It should be noted, however, that the takeover laws of some states and the provisions of some companies' charters and by-laws (the U.S. equivalents of memoranda and articles of association) limit the ability of acquirors to offer less valuable consideration in a "back end" merger.

Two further points are worthy of note in relation to the practicalities of a tender offer acquisition.

First, the making of the formal offer will frequently be preceded by purchases of target shares either on the open market or directly from a small number of shareholders. If carefully structured and implemented, such a buying program will permit the acquiror to establish a significant beachhead position without prematurely alerting the target or unduly inflating share prices. This can reduce the overall cost since such purchases will not usually involve payment of the premium associated with the acquisition of control. Federal disclosure and other obligations triggered by acquisitions of 5 per cent or greater are noted below, as are the notification obligations of the federal antitrust laws.

Secondly, consummation of a tender offer is often facilitated through the efforts of professional arbitrageurs and other speculators who, upon learning of a potential offer and believing that it or a competing offer may eventually succeed, will purchase a large number of target shares on the market with a view toward tendering to the winning bidder at a profit.

2. Mergers

Mergers are one of the more commonly utilised negotiated or "friendly" methods of accomplishing a corproate acquisition in the U.S. There is no equivalent form of transaction under Australian corporate law.

A merger, broadley defined, involves a transaction whereby an acquiror company, for payment of cash or securities or both, acquires all of the shares of a target company. Once the statutory merger requirements are completed, the target ceases to exist as a separate legal entity and is instead "merged" into the acquiror. Any rights formerly held by the target shareholders are automatically extinguished, being substituted for the right to receive the cash and/or securities of the surviving company that are the consideration for the merger.

Variations on the basic merger form involve the use of a shell subsidiary of the acquiror and, often, reversing the direction of the merger so that the target is itself the surviving corporation, becoming a wholly-owned subsidiary of the acquiror. the preferable form in any particular case will depend upon a number of factors, including the nature of the target's business, rights, contracts and regulatory requirements, applicable tax considerations and, perhaps most importantly, the requirements as to form of the applicable state corporation statutes.

Mergers are primarily governed by the laws of the state of incorporation of the target. Generally, these laws require approval of the merger transaction by the target shareholders. In the case of public companies, this shareholder approval requirement triggers the disclosure obligations of the federal proxy rules. These requirements are discussed generally below.

The choice between securities and cash as the merger consideration depends upon a number of factors. Use of the former subjects the acquiror to the registration and disclosure requirements attending any public issue of securities in the U.S. On the other hand, there are limitations in some states as to the use of cash, and, if the funds are to be raised in the U.S., the transaction may be subject to the federal margin regulations (which, among other things, regulate the use of credit in the purchase of securities in the U.S.). It should be noted that the ambit of the margin regulations has recently been extended to restrict the use of certain kinds of "high yield" securities to finance certain acquisitions in the U.S.

3. Asset Purchases

The considerations relating to business expansion by means of asset purchase arrangements are much the same in the U.S. as in Australia. An obvious attraction to the Australian investor is the potential for reducing regulatory and disclosure requirements attendant upon other acquisition forms. Purchase of all or a substantial part of a U.S. company's assets will, however, generally require the approval of share-holders, thereby triggering the requirements of the federal proxy rules which are discussed below. It should be noted that the U.S. does not impose stamp duties and, therefore, the stamp duty implications which play so significant a role in Australian asset purchase decisions need not be taken in to account.

4. Leveraged Buyouts

The term "leveraged buyout" describes a relatively recent (but now extremely significant) acquisition structure which may involve the use of one or more of the transactional forms discussed above. The target will usually be a large public company with distinct operating divisions. The objective is to take the company or certain of its divisions or subsidiaries private with a highly leveraged capital structure, reduce the amount of debt by selling certain assets over a period, and, ultimately, to re-offer equity securities to the public and thus permit the participants to realise their investment in the venture.

Leveraged buyouts usually involve (1) acquiring all of the shares or assets of the target, (2) an investor group supplying a small part of the purchase price as equity capital, and (3) a group of lenders financing the balance of the purchase price, upon the security of the assets and future cash flow of the company, and often participating in the equity.

The leveraged buyout structure, insofar as it involves the acquisition of target shares (as opposed to assets) where the security to the lenders is, directly or indirectly, to be provided by the target itself, could not presently be used to the same extentd in Australia because of the statutory prohibition on a company giving financial assistance (including the provision of collateral) in connection with the acquisition of its own shares. No such prohibition exists in the U.S.

5. Proxy Contests

A common method of acquiring corporate control in the U.S. which is not employed to the same extent in Australia, involves the control seeker (here generally termed the "insurgent") soliciting the votes of shareholders of the target company with a view to electing a dissident slate of nominee directors.

The percentage of target voting shares which an insurgent would need to hold or control in order to have a realistic chance of success in such a proxy contest will vary greatly from company to company. The most important determinants will generally be the identity and personality of the remaining shareholders (e.g. are they associated with existing management; are they institutions, arbitrageurs or unassociated individual investors?), and the strength and credibility of the insurgent's arguments for change and own proposals. Generally speaking, an insurgent with a positive plan for the company stands a greater chance of success with the shareholders electorate than someone merely making negative comments on existing management.

The principal advantage of proxy contests over other acquisition forms is that they are generally less expensive.

PRINCIPAL LEGAL REQUIREMENTS — A BRIEF OVERVIEW

Public corporations in the U.S. are regulated by both state and federal law. Each individual state has its own corporate statute, governing day-to-day corporate affairs and the mechanics of mergers which may vary considerably from state to state. In addition, many states have their own takeover laws which are discussed below. The principal federal statute concerning acquisitions is the Securities Exchange Act of 1934 (the "Exchange Act") which regulates large share purchases, tender offers and proxy contents. The Exchange Act is administered by the Securities and Exchange Commission (the "SEC").

1. Share Purchases — Disclosure and other Requirements

Section 13(d) of the Exchange Act and the rules promulgated thereunder by the S.E.C. regulate private share purchases which may have a potential effect on control of practically all companies whose shares are publicly traded in the U.S. It requires a purchaser to make prescribed disclosures whithin ten days after he crosses the 5 per cent beneficial ownership threshold of the target's shares.

The principal matters required to be disclosed centre around the identity and background of the purchaser and the nature of his beneficial ownership (broadly defined), the source and amount of his financing, and his purposes, including specific details of plans for the target if control is sought.

Group disclosure is required where two or more persons agree, formally or informally, to act together for the purpose of acquiring target shares.

The disclosure materials must be filed with the SEC, the target and each stock exchange where the target's securities are traded. No distribution to the target's shareholders is required. The materials are, however, publicly available and the financial press invariably ensures maximum dissemination of the information.

The disclosure requirement is an on-going one and amendments must be filed from time to time as material changes occur. There is a presumption that acquisitions or dispositions of 1 per cent or more of the target's shares are material for this purpose.

Holders of more than 10 per cent of the stock of a U.S. public company are also regulated by Section 16(b) of the Exchange Act. Under Section 16(b), when a 10 per cent holder disposes of all or part of his holdings within six months from their acquisiton, the company may be able to recover the difference between the various acquisition and sale prices.

2. Share Purchases — Regulation of the Tender Offer

Section 14(d) of the Exchange Act and the rules promulgated thereunder by the SEC regulate tender offers for the shares of practically all publicly traded U.S. companies where, after consummation of the offer, the offeror would be the beneficial owner of more than 5 per cent of the shares to which the offer relates.

The expression "tender offer" is not defined and there has been a degree of uncertainty as to the precise reach of Section 14(d). While regulation extends beyond the orthodox, formal offer, U.S. courts have generally been reluctant to hold programs consisting of open market purchases, privately negotiated transactions and other like means of acquisition to be tender offers for the purposes of the Exchange Act. A number of factors are applied in the determination, focussing upon the nature and terms of the individual offers and purchases made, the degree of solicitation and the pressure on offerees to sell.

The rules prohibit a person from making a tender offer unless as soon as practicable on the date of commencement he provides the SEC, the target, national securities exchanges on which the target's securities are registered and any other bidder who has an offer outstanding, with a statement containing specified disclosures including but extending beyond those required by Section 13(d). Unlike Australia, there is no minimum level above which purchases must be made by tender offer, although such a change in U.S. law has been proposed. In addition, there is no mandatory follow up bid requirement as there is in some Canadian jurisdictions.

While primarily disclosure-oriented, the rules also dictate the substantive terms of a tender offer insofar as they (1) prescribe the respective periods for which the offer must remain open and during which offerees must be given the right to withdraw tendered shares, (2) require that any increase in offered consideration be paid to all tendering shareholders, and (3) require that where the number of shares tendered exceeds the number sought, the offeror must purchase on a pro rata basis from all tendering shareholders.

Several of the tender offer rules apply to the target. It is required to facilitate dissemination of the offeror's materials, and must, within ten days of commencement of the offer, give to its shareholders a statement of its position with respect to the offer or a statement explaining why it cannot take a position. The target may not make a recommendation or solicitation with respect to a tender offer without filing with the SEC, the offeror and, where appropriate, national securities exchanges, a disclosure statement dealing with its recommendations and reasons therefore, any conflicts of interest and any negotiations being undertaken with third parties in response to the offer, including negotations with "White Knights", *i.e.*, potential acquirors more acceptable to management.

3. Mergers, Asset Purchases and Proxy Contests — Regulation of Shareholder Solicitation

Section 14(a) of the Exchange Act and the rules promulgated thereunder by the SEC regulate any proxy solicitation directed to more than ten persons in respect of securities of the publicly-held U.S. company. The primary purpose is to protect shareholders by preventing any person obtaining proxies by means of inadequate or deceptive disclosure.

In connection with a merger or substantial asset acquisition, proxies will be solicited from shareholders of the target company for their vote to approve the transaction. In a proxy contest for the election of directors, proxies will be solicited by both incumbent management and the insurgent for votes in favour of their respective nominee slates.

The general effect of the proxy rules is to require that any person from whom a proxy is to be solicited must first be furnished with a proxy statement approved by the SEC which discloses certain material information.

4. State Takeover Laws

In addition to the federal laws discussed above, many individual states have enacted takeover laws, applying to takeovers of companies incorporated or operating in that state, or to shareholders residing in that state to whom a bid is addressed. State takeover laws have traditionally restricted takeovers by supplementing the waiting periods and disclosure requirements of the federal securities laws.

In 1982 the U.S. Supreme Court declared the Illinois takeover statute unconstitutional, and, in so doing, placed the status of similar statutes in question. Many states have responded with new forms of takeover statutes. There have been three major approaches: (1) requiring a supermajority vote of a company's shareholders to approve specified types of extraordinary transactions between a significant shareholder and the company unless certain "fair price" criteria are met, (2) requiring the vote of a majority of disinterested shareholders to approve certain share acquisitions which would confer specified degrees of control, and (3) obliging an acquiror of a specified percentage of voting shares to pay to all remaining shareholders, upon demand, the fair value of their shares in cash.

5. Antitrust Laws

The U.S. antitrust laws prohibit, among other things, any company from acquiring, by whatever means, the shares or assets of any other company where the transaction might have the effect of substantially lessening competition or tending to create a monopoly. Since these laws focus on the effect of an acquisition on competition within the U.S., they will have limited practical effect upon Australian acquirors who are not already in competition with their U.S. target, or among the few companies which have the potential of entering into such competition. There are, however, pre-acquisition waiting and notification requirements imposed by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 which are triggered by most substantial acquisition transactions. Their objective is to afford federal government agencies the opportunity to review proposed acquisitions before their consummation to determine whether or not further investigation or legal action is warranted under the antitrust laws.

6. Reporting Foreign Direct Investment in the U.S.

Foreign direct investment in the U.S. is subject to federal reporting requirements established under the International Investment Survey Act of 1976. Broadly speaking, most acquisitions of 10 per cent or more of a U.S. business, incorporated or unincorporated, will trigger the requirements, which generally call for an initial and certain periodic reports but do not impose any other substantive obligations.

7. Regulated Industries

Foreign acquisitions of certain interests in U.S. companies involved in "regulated industries" may be prohibited, restricted or subject to some form of governmental approval. Examples of regulated businesses include domestic air carriers, atomic energy facilities, merchant fleet vessels, radio and television stations, insurance companies, banks and savings and loan companies, defence facilities, public utilities and alcoholic beverages.

8. Defensive Stategies

A matter which is possibly of concern to a potential Australian investor is the barriers which management of an unwilling U.S. target may attempt to erect in its path.

The U.S. target has a large arsenal of defensive techniques, including open market purchases of its own shares, counter tender offers, self exchange offers and defensive charter and by-law provisions (such as the "poison pill"). However, while it is true that directors in the U.S. enjoy greater flexibility in this regard than their Australian counterparts, this consideration should not necessarily by regarded as a substantial impediment. Recent cases suggest that the courts may now look more closely at the proprietary of certain defensive strategies. Moreover, it has often been suggested that from a practical point of view the takeover rules are still heavily weighted in favour of the bidder. U.S. experience suggests that a properly advised and sufficiently funded acquiror stands a good chance of ultimate success, even in the face of defensive manoeuverings.

CONCLUSION

There is every indication that the trend of increased foreign investment in the U.S. will continue. In the U.S. there is no general regulation of foreign investment and, generally speaking, an Australian investor is in the same position as a U.S. company. There are a number of possible structures by means of which an acquisition may be effected. Each is the subject of certain legal requirements and principles. The mere possibility of defensive action should not preclude serious consideration being given to what is otherwise an attractive investment opportunity.