THE "PROPER PURPOSES" DUTY OF DIRECTORS AND DEFENSIVE MEASURES AGAINST COMPANY TAKEOVERS

PINE VALE INVESTMENTS LTD. v. *McDONNELL AND EAST LTD.*[1]

Introduction

It is well established that the directors of a company are fiduciaries. One of their duties is to exercise their powers for the purpose or purposes for which they were conferred and not "in order to obtain some private advantage or for any purpose foreign to the power".[2] This obligation cast on a director is commonly known as the "proper purposes" duty. L. C. B. Gower regards the proper purposes duty as quite distinct from the duty of directors to exercise their powers *bona fide* for the benefit of the company as a whole.[3] However, as Professor Lindgren has shown from an examination of the decided cases, often the courts seem to have viewed the proper purposes duty as a sub-class of the general formula that directors act "*bona fide* for the benefit of the company as a whole".[4]

When establishing whether or not there has been a breach of the proper purposes duty, the Court must:

(i) assess, as a question of law, the purpose or purposes of the power in question; and
(ii) determine, as a question of fact, whether the directors have used the power otherwise than for the purpose or purposes for which it was conferred.

The determination of this question of fact occasions a consideration of the motives, intentions and purposes of a number of individuals, which are invariably difficult to determine. Where the courts are required to consider a multiplicity of purposes they have generally directed their attention to determining, in accordance with Dixon, J.'s test in *Mills* v. *Mills*, the "substantial object the accomplishment of which formed the real ground of the board's action".[5] If the substantial purpose is a proper purpose, the actions of the directors will be valid. Dixon, J. added that if,

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[1] (1983) 1 A.C.L.C. 1294.

[2] *Mills* v. *Mills* (1938) 60 C.L.R. 150 at 185-6, *per* Dixon, J.

[3] *Gower's Principles of Modern Company Law* (4th ed. by L. C. B. Gower, J. B. Cronin, A. J. Easson and Lord Wedderburn of Charlton, 1979). The expression "company as a whole" means the present and future members of the company: *id.* 577-8.

[4] K. E. Lindgren, "The Fiduciary Nature of a Company Board's Power to Issue Shares" (1971-2) 10 *West.Aust.L.Rev.* 364 at 370-72.

[5] *Supra* n. 1.

> . . . except for some ulterior and illegitimate object, the power would not have been exercised, that which has been attempted as an ostensible exercise of the power will be void, notwithstanding that the directors may incidentally bring about a result which is within the purpose of the power and which they consider desirable.[6]

The decided cases in this area illustrate the difficulty of providing impropriety of purpose. As Latham, C.J. stated in *Richard Brady Franks Ltd.* v. *Price*, a court

> . . . does not presume impropriety. . . . The onus is on the plaintiff who challenges the action of the directors to establish that they did not act *bona fide* for the benefit of the company.[7]

A fact situation which often gives rise to litigation in this area is where the directors of a company which is the subject of a takeover engage in a course of action which may have the effect of frustrating the takeover. In such circumstances the courts' intervention has often been sought on the ground that the directors have exercised their powers for an improper purpose and that as a result, the shareholders in the target company have not been allowed an adequate opportunity to evaluate the takeover offer.

Many of the cases have concerned the power of directors to issue shares. The courts have recognised that an exhaustive definition of the possible purposes of the power to issue shares is not practicable. As a company often benefits commercially from an issue of shares, it is difficult to distinguish between action taken with the substantial purpose of conferring a commercial benefit on the company and action taken which is aimed substantially at maintaining the directors' own positions or those of the existing majority shareholders, in the face of an existing or imminent takeover offer. In *Pine Vale Investments Ltd.* v. *McDonnell and East Ltd.*[8] McPherson, J. of the Supreme Court of Queensland considered the proper purposes duty in relation to directors' defensive tactics in the face of an attempted company takeover.

The Facts and Decision

McDonnell and East Ltd. ("McDonnell") had an issued share capital of 3,000,000 shares at $1.00 each. The company had successfully carried on the business of a retailer since 1901 and its shares were being quoted on the stock exchange at prices in excess of $5.00.

On 31 May, 1983 a takeover announcement was made by Pine Vale Investments Ltd. ("Pine Vale"). Pine Vale and associated persons and companies were entitled to 26 per cent of the share capital of McDonnell. On 13 June, 1983, one month before Pine Vale's Part A Statement was registered, representatives of McDonnell entered into negotiations aimed at acquiring some trading outlets of Pigott & Co. Pty. Ltd. ("Pigott"). On 12 July, 1983, after various meetings between representatives of McDonnell and Pigott, the board of directors of McDonnell resolved to

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[6] *Ibid.*

[7] (1937) 58 C.L.R. 112 at 135, *per* Latham, C.J.

[8] (1983) 1 A.C.L.C. 1294 (hereafter *Pine Vale*).

make an offer to acquire Pigott's business and to fund the purchase by issuing one for two shares to existing shareholders.

On 14 July, 1983 Pine Vale's Part A Statement was registered and its formal offer was due to be dispatched on 29 July, 1983. Two days before this, on 27 July, by means of a press release, a letter to the Brisbane Stock Exchange, and a circular to shareholders, the board of McDonnell announced that it had entered into a contract for the purchase of Pigott's trading outlets and outlined the method of financing the transaction. In the *same* circular to shareholders, the board furnished details of the effect of Pine Vale's partial takeover offer and of what was alleged to be Pine Vale's poor financial record. The effect of the proposed rights issue would be to change the number and the market value of the issued shares, thereby affecting the assumptions on which the takeover offer was made. The managing director of Pine Vale stated in court that if the share issue proceeded, his company would not proceed with the takeover.

On 28 July, 1983, Pine Vale sought and obtained an interim injunction to restrain McDonnell from completing the purchase and from proceeding with the rights issue. The case then arose for hearing before McPherson, J. in the Supreme Court of Queensland. His Honour gave judgment for McDonnell, holding that the directors had discharged their duty to the company.

Previous Authorities

As indicated earlier, the courts have held that a power is validly exercised if the "substantial object" forming the "real ground" of the board's action is within the scope of the power. The Privy Council in *Howard Smith* v. *Ampol Petroleum Ltd.*[9] accepted that, when determining whether the directors have made a decision for one or another purpose, or which of several purposes was the "substantial" one, credit must be given to the *bona fide* opinion of the directors. Their Lordships also stated that it would be wrong for the court to substitute its opinion for that of management, or indeed to question the correctness of the management's decisions "if *bona fide* arrived at". However, Lord Wilberforce, delivering the judgment of their Lordships, emphasised that the court

> . . . is entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial, or *per contra*, insubstantial an alleged requirement may have been. If it finds that a particular requirement, though real, was not urgent, or critical, at the relevant time, it may have reason to doubt, or discount, the assertion of individuals that they acted solely in order to deal with it, particularly when the action they took was unusual or even extreme.[10]

In *Howard Smith* Street, J. at first instance had looked at the "objective state of Miller's financial position"[11] to test the assertions of the directors of R. W. Miller (Holdings) Ltd. that their primary purpose

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[9] [1974] A.C. 821 (hereafter *Howard Smith*).
[10] *Id.* 832.
[11] *Ampol Petroleum Ltd.* v. *R. W. Miller* [1972] 2 N.S.W.L.R. 850 at 872.

in allotting shares to Howard Smith Ltd. was to satisfy a pressing need for capital. That the company was in need of capital was accepted by Street, J. However in his opinion this need had been recognised for many months before the allotment and in the past the company had pursued a policy of raising money by loans rather than share capital. Street, J. concluded that the primary purpose of the directors was to "reduce the proportionate combined shareholding of Ampol and Bulkships in order to induce Howard Smith to proceed with its takeover offer".[12] Street, J. described as "unconvincing" the directors' assertions that their dominant purpose was to obtain capital rather than to promote the Howard Smith takeover offer. His Honour concluded that he did not believe these assertions.[13] The factors which Street, J. regarded as supporting his conclusion were that the board had not considered the diminution of the shareholders equity, the taxation position, cash flow projections or the current overall position. In addition, the fact that under the agreement with Howard Smith, Millers accepted considerable restraints on its freedom to issue further shares provided

> . . . strong corroboration that the directors regarded the allotment to Howard Smiths as virtually concluding a takeover of Millers by Howard Smiths. The directors were concerned to achieve the fact of the allotment rather than to investigate and deliberate upon the terms for which Howard Smiths stipulated. Indeed the terms, even the price, appear to have been accepted without analysis.[14]

These findings were accepted by the Privy Council. Their Lordships affirmed that it is

> . . . unconstitutional for directors to use their fiduciary powers over shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist.[15]

In *Hogg* v. *Cramphorn Ltd.*[16] the directors acknowledged that their purpose in issuing shares was to maintain the existing control of the company. They were, however, motivated by an honest belief that the maintenance of existing control was for the benefit of the company. Buckley, J. held that such an honest belief could not legitimate a share issue made for the purpose of preserving existing control. This decision was affirmed in *Howard Smith.*

In contrast to these cases are the cases of *Teck Corporation Ltd. v. Millar*[17] and *Harlowe's Nominees Pty. Ltd.* v. *Woodside (Lakes Entrance) Oil Co.*[18] In the latter case the High Court upheld an allotment of shares which the directors *bona fide* believed was necessary to secure financial stability, notwithstanding that it also defeated an attempted takeover and the directors were aware that it would have this effect. The

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[12] *Id.* 879.
[13] *Id.* 878.
[14] *Id.* 877.
[15] *Supra* n. 9 at 837.
[16] [1967] Ch. 254.
[17] (1973) 33 D.L.R. (3d.) 288 (hereafter *Teck Corporation*).
[18] (1968) 121 C.L.R. 483 (hereafter *Harlowe's Case*).

"ultimate question", the Court said, "must always be whether in truth the issue was made honestly in the interests of the company".[19]

The substance of Berger, J.'s judgment in *Teck Corporation* was that where directors seek to prevent a majority shareholder from exercising control over the company because they believe on reasonable grounds that what they are doing is in the best interests of the company, their actions will not be deemed improper. In contrast with the decision in *Howard Smith*, Berger, J. concentrated on establishing not what the directors *ought* to have done as the correct course in the particular circumstances but what the reasonable director *might* have done in the circumstances. Directors, he said, are entitled to consider the reputation, experience and policies of anyone seeking to take over the company:

> If they decide, on reasonable grounds, a takeover will cause substantial damage to the company's interests, they are entitled to use their powers to protect the company.[20]

Berger, J. stressed that "something more" than mere assertions of good faith would be required. In his Honour's opinion the correct test was that laid down by Scrutton, L.J. in the English Court of Appeal in another context in *Shuttleworth* v. *Cox Brothers & Co.*:

> . . . when persons, honestly endeavouring to decide what will be for the benefit of the company and to act accordingly, decide upon a particular course, then, provided there are grounds on which reasonable men could come to the same decision, it does not matter whether the court would or would not come to the same decision or a different decision.[21]

Berger, J. affirmed the general rule laid down by Lord Greene, M.R. in *Re Smith & Fawcett Ltd.*:

> . . . [the directors] must exercise their discretion *bona fide* in what they consider—not what a court may consider—is in the interests of the company, and not for a collateral purpose.[22]

His Honour rejected as inconsistent with this rule the decision in *Hogg* v. *Cramphorn Ltd.* It seemed, in his opinion, to suggest that directors have the right to consider the interests of the company and to exercise their powers accordingly but that in the exceptional case of the power to issue shares, the directors cannot in any circumstances issue shares to defeat an attempt to gain control of the company.[23]

The Privy Council in *Howard Smith* rejected as "too narrow an approach" the idea that the only valid purpose of the power to issue shares is to raise capital. Their Lordships also criticised, as a test of the legitimate purpose of a share issue, that the directors must have acted "*bona fide* in the interests of the company as a whole": this failed to encompass the obligations of directors to be fair as between classes of shareholders.[24]

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[19] *Id.* 493.
[20] *Supra* n. 17 at 317.
[21] [1927] 2 K.B. 9 at 23.
[22] [1942] Ch. 304 at 306.
[23] *Supra* n. 17 at 312.
[24] *Supra* n. 9 at 835.

At the same time, however, Lord Wilberforce affirmed the validity of *Teck Corporation* and *Harlowe's Case.* He cited, *inter alia*, the following statement from *Harlowe's Case*, with apparent approval:

> . . . [the] ultimate question must always be whether in truth the issue was made honestly in the interests of the company.[25]

Lord Wilberforce then distinguished both *Teck Corporation* and *Harlowe's Case* on the ground that in *Howard Smith* the purpose found by Street, J. was "simply and solely to dilute the majority voting power held by Ampol and Bulkships".[26]

The *Howard Smith* decision was not cited by Waddell, J. in *Winthrop Investments Ltd* v. *Winns Ltd. (No. 2)*[27] who applied Dixon, J.'s "substantial purpose" and "but for" tests.[28] Waddell, J. held that notwithstanding that the directors of Winns Ltd. would not have entered into negotiations for the acquisition of the retail stores at the particular time in question "but for" their desire to deter an imminent takeover offer, this desire was still a secondary object. The "substantial object" was "to employ the assets and organisation of the company more profitably to the advantage of the general body of shareholders".[29] In Waddell, J.'s opinion,

> . . . the intimation of the likelihood of the making of a take-over offer should be regarded as bringing home to them forcibly the business necessity of acquiring new retail outlets for the company.[30]

In arriving at this conclusion, Waddell, J. looked at the situation objectively and considered the commercial advantages which would flow from the acquisitions and the fact that negotiations to purchase the stores had commenced before Winns Ltd. became aware of a possible takeover.

It was not necessary for Waddell, J. to consider the alternative submission by Winns Ltd. that even if the object of preventing the making of a takeover offer except at a proper price for the shares was not a secondary one, it was nonetheless a purpose "the accomplishment of which was *bona fide* in the interests of the company as a whole and did not invalidate the decision."[31] That the achievement of a "proper price" is a justification for acting to frustrate a takeover was rejected by the Privy Council in *Howard Smith.* G. F. K. Santow has cogently argued that this approach is correct:

> The company as an on-going commercial entity is not overly concerned with the price paid to obtain control of the company. It is rather concerned with what the new controllers will do *for* the company or *to the detriment of* the company.[32]

Santow concluded that the fairness of the price is a relevant considera-

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[25] *Id.* 836.
[26] *Id.* 837.
[27] (1979) 4 A.C.L.R. 1 (hereafter *Winthrop*).
[28] *Supra* n. 2.
[29] *Supra* n. 27 at 11.
[30] *Id.* 12.
[31] *Id.* 4.
[32] "Defensive Measures Against Company Take-overs" (1979) 53 *A.L.J.* 374 at 378, 380-1.

tion but directors are not justified in frustrating an offer on this ground alone.

In *Rossfield Group Operations Pty. Ltd.* v. *Austral Group Ltd.*[33] the action of the directors of A.M.H. Ltd. was the promotion of a company which, once incorporated, made a successful takeover offer for A.M.H. Ltd. This took place after a takeover offer had been communicated by the plaintiff company. Connolly, J. in the Supreme Court of Queensland found that the steps taken had all "formed part of A.M.H.'s resistance to the plaintiffs' takeover offer".[34] Nevertheless, the directors had done nothing to change the balance of stockholding or to interfere with the company's constitution and, therefore, in his Honour's opinion, the case was distinguishable from *Howard Smith*. The substantial purpose of the directors was

> . . . to obtain for all the stockholders what they considered to be the true value of their stock and to protect the company against the possible loss of its franchises in the event of a change of control.[35]

In Connolly, J.'s opinion, the directors could not be regarded as having acted otherwise than honestly and in the interests of the company.

The idea that there is no general principle precluding directors from using their powers to frustrate a takeover offer, but merely a principle prohibiting directors from issuing shares in order to create a new majority or to destroy an existing majority, was taken a step further by Megarry, V.-C. in the recent English case of *Cayne* v. *Global Natural Resources P.L.C.*[36] Megarry, V.-C. considered the situation of directors who issue shares in order to preserve their existing control in the honest belief that this is for the good of the company. He suggested that the principle expressed in *Hogg* v. *Cramphorn* that an honest belief does not prevent such an issue of shares from being an improper exercise of directors' powers, must not be carried too far. Megarry, V.-C. then gave an example:

> If Company A and Company B are in business competition and Company A acquires a large holding of shares in Company B with the object of running Company B down so as to lessen its competition, I would have thought that the directors of Company B might well come to the honest conclusion that it was contrary to the best interests of Company B to allow Company A to effect its purpose, and that in fact this would be so. If then, the directors issue further shares in Company B for the purpose of defeating Company A's plans and continuing Company B in competition with Company A I cannot see why that should not be a perfectly proper exercise of the fiduciary powers of the directors of Company B. The object is not to retain control as such, but to prevent Company B from being reduced to impotence and beggary, and the only means available to the directors for achieving this purpose is to retain control. This is quite different from directors seeking to retain control

[33] [1980] 5 A.C.L.R. 290 (hereafter *Rossfield Group*).

[34] *Id.* 292.

[35] *Id.* 296.

[36] Chancery Division, 12 August, 1982, unreported; noted in (1982) 56 *A.L.J.* 600. Affirmed by the Court of Appeal: [1984] 1 All E.R. 225 (hereafter *Cayne*).

> because they think that they are better directors than their rivals would be.[37]

Megarry, V.-C. added that the *Harlowe's* and *Teck Corporation* cases "go some way towards supporting such a restriction on the scope of *Hogg* v. *Cramphorn Ltd.*"[38] Furthermore, he said, "*Mills* v. *Mills* shows that where the main purpose of the directors' resolution is to benefit the company it matters not that it incidentally benefits a director".

If this suggested "restriction" is accepted it may be, as R. I. Barrett has suggested, that if the directors genuinely believe that a substantial shareholder will by virtue of his shareholding cause actual economic or commercial harm to the company, the directors may legitimately seek to preserve existing control by exercise of their powers over unissued shares.[39] Barrett admitted that the degree of apprehended harm required is unclear but suggested that gross detriment or fraud on the minority may be examples.

It seems that Megarry, V.-C.'s propositions go further than the decision in *Teck Corporation* where Berger, J. required not only an honest but also a *reasonable* belief on the part of the directors that they are acting substantially for the benefit of the company:

> If [the directors] say that they believe there will be substantial damage to the company's interests, then there must be reasonable grounds for that belief.[40]

Megarry, V.-C.'s requirement of only an honest belief seems to ignore the evidentiary difficulties of proving *mala fides* on the part of the directors.

McPherson, J.'s Judgment

Counsel for Pine Vale argued that McDonnell entered into the "Pigott transaction" with the aim of defeating Pine Vale's takeover offer and that "but for" this object the transaction would not have been embarked upon. In support of these contentions counsel relied on the content, form and timing of what was an "improvident transaction" and the method of financing the contract. McPherson, J. considered each of these elements objectively before coming to the conclusion that the directors had not acted in breach of their duty to the company.

His Honour examined in some detail the terms of the contract and the evidence of the McDonnell directors and of accountants and retailers on behalf of both parties. He held that, at least with regard to the decision to enter into the contract,

> . . . the substantial object forming the real ground of the board's action was not the frustration of the takeover offer but the desire to take advantage of a genuine commercially favourable opportunity.[41]

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[37] Cited in *ibid.*
[38] *Ibid.*
[39] *Ibid.*
[40] *Supra* n. 17 at 313.
[41] *Supra* n. 8 at 1304.

While the directors varied in their response to the question whether they had been influenced by the takeover announcement by Pine Vale, each of them was "insistent that he genuinely regarded the purchase of the Pigott business to be commercially advantageous".[42] Their opinion was, according to his Honour, "objectively justified". It is worth noting that McPherson, J. continued:

> Had I formed a different view, an adverse finding with respect to their motivation might have followed, perhaps not of course, but certainly without great difficulty.[43]

Thus it seems an "honest belief" that the transaction was for the benefit of the company as a whole may not have been sufficient to satisfy McPherson, J.

With regard to the timing of the directors' actions, McPherson, J. expressed the view that it was "impossible" to avoid the conclusion that "some part at least" of McDonnell's actions was influenced by the timetable of Pine Vale's take-over offer.[44] However his Honour applied the principles concerning timing expounded by Waddell, J. in *Winthrop Investments*. He concluded that even assuming, as to which his Honour made no finding, that "but for" the takeover offer the transaction would not have occurred when it did this did not mean that the propriety of the decision to purchase was vitiated by an ulterior and illegitimate purpose:

> Once it is established that action is commercially justified in the corporate interest, it is difficult to understand why the directors should be reduced to inertia because of the pendency or possibility of a takeover offer.[45]

This statement represents an extension of the *Winthrop Investments* decision. It could be relied on to justify a wide range of activities by directors facing the threat of a takeover, provided that such activities are "commercially justified in the corporate interest".

This may be contrasted with the criticism of the "benefit to the company" criterion by the Privy Council in *Howard Smith*. In any event, McPherson, J. decided that McDonnell would at some time have acquired the Pigott business or some other business of comparable magnitude and there had been at least one previous attempt in 1974 to purchase the Pigott business.

On the propriety of the share issue, McPherson, J. stated that it was clear that it would have a preclusive effect on Pine Vale's takeover offer and this could have been avoided by raising funds through a loan. His Honour considered the advantages and disadvantages of both share issues and loans as methods of securing finance. He concluded that there was no doubt that McDonnell, viewed as a corporate entity, would benefit by raising the funds by share issue rather than by loan and it was consistent with past policy of the board that heavy borrowing should be avoided. In raising the capital required by share issue, his Honour concluded, the

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[42] *Id.* 1303.
[43] *Ibid.*
[44] *Id.* 1302.
[45] *Id.* 1304.

directors were motivated primarily by considerations of corporate advantage rather than a desire to thwart a takeover; accordingly they had discharged their duty to the company. Again, in contrast to *Howard Smith*, the criterion relied on was "benefit to the company". His Honour added that where, as was the case here, no question arises as to discrimination as among shareholders or classes of shareholders *inter se*, the directors should not be required to ignore their duty to the corporate entity and instead attempt to determine whether fewer or more shareholders will be advantaged or disadvantaged by the proposed action.[46]

As a consequence of his conclusion on the facts, McPherson, J. found it unnecessary to determine the validity of the submission made by counsel for McDonnell that there is no general principle which precludes directors from using their powers to defeat a takeover offer, but simply a principle preventing directors from issuing shares in order to create a new majority or to destroy an existing majority in general meeting.[47] In support of this proposition, counsel cited the *Australian Metropolitan, Howard Smith* and *Rossfield Group* decisions. McPherson, J.'s only comment on the submission was that parts of the judgments in those cases "go some way to supporting the proposition advanced".[48]

It is true that, particularly in recent years, the courts have begun to accept that an issue of shares designed to thwart a takeover is not *per se* invalid on the impropriety of purpose ground. In fact some of the cases referred to earlier have advanced beyond what counsel for McDonnell propounded as the law. The *Cayne* decision suggests that an issue of shares to create a new majority or to preserve existing control will not be in breach of the directors' duty if they have acted substantially in the honest belief that their actions are for the benefit of the company as a whole because the proposed change in control will be substantially deleterious to the interests of the company.

Notwithstanding the criticisms by the Privy Council in *Howard Smith* of the "benefit to the company as a whole" criterion, it has been applied in most cases, including *Pine Vale*. It is submitted that this is the correct test and that, as G. F. K. Santow has argued, fairness between groups of shareholders

> . . . has relevance only where these groups are identified classes and class rights are "unfairly", in the sense of "injuriously", affected. It should not extend to cases concerned merely with majority/minority shareholders.[49]

As McPherson, J. advised, if a sufficient number of shareholders believe themselves to be adversely affected by the action proposed, "the remedy lies in their hands at the next annual general meeting, when directors present for re-election".[50]

The *Pine Vale* case exemplifies the difficulty of challenging directors' actions, particularly where those actions confer a commercial benefit on

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[46] *Id.* 1305.
[47] *Ibid.*
[48] *Ibid.*
[49] *Supra* n. 32 at 378.
[50] *Supra* n. 8 at 1305.

the company, unless a clear case of personal advantage or discrimination among classes of shareholders *inter se* is established.

Since the *Pine Vale* decision, Powell, J. in the Supreme Court of New South Wales in *Russell Kinsela Pty. Ltd.* v. *Kinsela* has expressly affirmed the passage in *Howard Smith* criticising the "benefit to the company" test.[51] His Honour did not refer to either *Pine Vale* or *Winthrop* in coming to his conclusion that the

> . . . true duty of directors is a duty to refrain from exercising any of the powers vested in them in order to obtain for themselves some private advantage or in order to achieve some other object other than that for which the power was vested in them.[52]

Thus the standing of the principles stated in *Pine Vale, Winthrop* and *Cayne* in New South Wales is uncertain.

In conclusion, it should be noted that section 60 of the Companies (Acquisitions of Shares) Act 1980 (Cth.) has been amended by the Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 (Cth.). The amendments enlarge the power of the National Companies and Securities Commission to declare conduct to be "unacceptable" irrespective of whether a Part A Statement has been served or a takeover announcement has been made. Defensive conduct by a target company in anticipation of a takeover offer can be the subject of a declaration if it has the effect of denying to shareholders:

(i) knowledge of the identity of the offeror;
(ii) a reasonable time in which to consider an offer;
(iii) sufficient information to assess the merits of the offer; or
(iv) reasonable and equal opportunity to participate in the benefits of the offer.

The efficacy of this provision in preventing defensive measures against takeovers will, of course, depend heavily on the facts of the case in question. It is possible that in many takeover situations none of the criteria laid down in section 60 will be satisfied.

Another statutory provision which may be relevant in the present context is the new section 320 of the Companies Code. The section enables a member to apply to the court for an order under section 320(2) if, *inter alia*, such member believes that an act or omission or resolution by the company would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members (whether in their capacity as members or in any other capacity[53]), or would be contrary to the interests of the members as a whole. It has been suggested that the "unfairly prejudicial" head of jurisdiction in the section could be relied upon to attack defensive measures against takeovers.[54]

The novelty of these statutory provisions in relation to defensive conduct lies in the fact that their application does not depend on

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[51] (1983) 8 A.C.L.R. 384 at 405.

[52] *Id.* 404.

[53] S.320(4A)(b).

[54] R. P. Austin, "Protection of Minority Shareholders: Changes to Section 320" in *Companies and Securities Legislation – The 1983 Bill* (University of Sydney, Committee for Postgraduate Studies in the Department of Law, December 1983).

establishing the motives or purposes of the directors. It is possible, however, that the reluctance of the courts to interfere with management decisions[55] may circumscribe the potentially wide application of the sections.

In the area of law reform, an American, Associate Professor R. J. Gilson, has suggested an alternative method of regulating defensive conduct.[56] He argues that the emphasis on directors' motives and purposes can never resolve the problem of defensive tactics in takeovers. He affirms the policy behind the United Kingdom City Code on Takeovers and Mergers which is that it is for the offeree *shareholders* to decide whether or not an offer shall succeed. He proposes the following "rule" as a solution to the problem:

> During the period commencing with the date on which target management has reason to believe that a tender offer may be made for part or all of a target company's equity securities, and ending at such time thereafter that the offeror shall have had a reasonable period in which to present the offer to target shareholders, no action shall be taken by the target company which could interfere with the success of the offer or result in the shareholders of the target company being denied the opportunity to tender their shares, *except* that the target company (1) may disclose to the public or its shareholders information bearing on the value or the attractiveness of the offer, and (2) may seek out alternative transactions which it believes may be more favourable to target shareholders.[57]

Associate Professor Gilson argues cogently that with this approach the determining issue is not the wisdom or good faith of the directors' action, but rather what type of action, if any, has been taken. He concludes: "in other words, the approach has the flavour of *ultra vires*—certain actions are simply outside management's authority".[58] The advantage of the suggested reform, by prescribing a period in which defensive measures cannot be taken, is that it clearly delineates the obligations of the directors of a company and the scope of permissible activity. The disadvantage of such a rule is that it may operate as an excessive restriction on the freedom of a company to engage in normal commercial activities. In *Pine Vale*, for example, such a rule would have prohibited the purchase by McDonnell of the Pigott business without shareholder approval, thereby possibly preventing McDonnell from taking advantage of a commercially favourable opportunity.

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[55] See, for example, *Re H. W. Thomas Ltd* (1983) 1 A.C.L.C. 1256.

[56] R. J. Gilson, "A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers" (1981) 33 *Stan.L.R.* 819. See also F. H. Easterbrook and D. R. Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94 *Harv.L.R.* 1161.

[57] *Id.* 878-9.

[58] *Id.* 879.