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# Social Benefits of the Equal Opportunity Rule in Takeovers and Mergers of Companies in Malaysia and United Kingdom

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## ABSTRACT

The Equal Opportunity Rule (EOR) is the foundation of takeover laws in the United Kingdom and Malaysia. Under the rule, fairness in takeover is considered achieved through affording equal treatment to all shareholders of the target company in four aspects, namely rights to disinvestment, equal premium, information and decision making. The notion of equality favours shareholders and imposes higher burden on the acquirer. From qualitative studies of the rule and comparative analysis between Malaysia and the UK, it may be concluded that the ultimate benefit of the rule is to enable shareholders of a target company to make an informed decision on whether to remain as shareholders after being communicated on the potential changes to the target company and offered with a fair price to exit the company. As shareholders represent larger segment of the society, the rule that favours the majority will directly benefits the society and prevails. Hence, we maintain that the rule should be preserved in the Malaysian takeovers law because social benefit derived from it outweighs harms that it causes to acquirers and are necessary to protect shareholders of the target company from greater harms that takeover might causes in its absence.

*Keywords:* Equal opportunity, mandatory bid, shareholder's protection, sharing rule, takeover

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## INTRODUCTION

A shift in corporate control via takeover presents real risk to a target company's minority shareholders especially when an acquirer intends to change the company's *status quo*. Thus, many jurisdictions regulate takeovers to protect minority shareholders' interest while at the same time keeping takeovers no less attractive. Some

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jurisdictions require an acquirer to undertake certain compulsory measures to ensure acquisition of corporate control is not at the expense of minority shareholders. Others require the target company's management to act in the company's best interest to get the best deal available in the market and create a competitive takeover environment. From these competing perspectives, 2 rules were developed namely the EOR which focuses on the acquirer's responsibilities and the Market Rule (MR) which concentrates on director's duties and competitiveness in takeover deals. In this paper, we intend to uncover the social benefits of the EOR via qualitative studies on its salient features in order to suggest whether it should remain as the guiding principle for Malaysian takeover laws. Since Malaysian law has many common features with the English law, comparative analysis is also made.

## THE EQUAL OPPORTUNITY RULE

The EOR is triggered once a person together with persons acting in concert with him acquires shares that allows them to have "effective control" over a public company. The acquisition of shares in a private or public company which does not lead to effective control is not subject to the EOR but is transacted in accordance with the MR. The history of the EOR can be traced to the UK's takeover regulatory regime specifically the City Code on Takeovers and Mergers (City Code) (Bruslerie, 2013; Schuster, 2010). It refers to a rule where the acquirer has an obligation during takeover proceedings to afford the same treatment to all shareholders of a same class in the target company. This rule imposes duties on an acquirer to give due consideration to shareholders (Balta, 2013).

When it was first established in 1968, the City Code consisted of 10 General Principles (GP) the first of which stated, "*All shareholders of the same class of a target company must be treated similarly by the offeror*" while the eighth GP stated, "*Rights of control must be exercised in good faith and the oppression of a minority is wholly unacceptable*" (Johnston, 2007; Roberts & Wiseman 1990). These principles became the foundation of the EOR (Jennings, 2005) which resulted in the formation of various safeguards to the interest of shareholders during takeover proceedings. The City Code is the main instrument which governs takeovers in the UK since 1968. It was initially a standalone instrument without any force of law with objectives "*to reflect the collective opinion of those professionally involved in the field of takeovers as to appropriate business standards and as to how fairness to shareholders and an orderly framework for takeovers can be achieved*" (The Takeover Panel). After almost 40 years operated as a soft law which depended on public censure as the main sanction against non-compliance (Johnston, 2007) and after being revised more than 5 times, the City Code finally had statutory basis in 2006 following the UK's implementation of the EU Takeover Directive through Part 28 UK's Companies Act 2006. The current 11th edition of the City Code is based on 6 GP (The Takeover Panel).

In Malaysia, takeover activities are mainly governed by Division 2 Part VI Capital Market and Services Act 2007 (CMSA), the Malaysian Code on Take-Overs and Mergers 2016 (2016 Code) issued pursuant to S. 217 CMSA and the Rules on Take-Overs, Mergers and Compulsory Acquisitions (TOM Rules 2016) issued pursuant to S. 377 CMSA. The current 2016 Code came into force in 15 August 2016. The Code is administered by the Securities Commission (SC) which was established by the Securities Commission Act 1993. After being revised 3 times through the 1998 Code, the 2010 Code and finally the 2016 Code, the latest Code "*sets out the broad principles to be adhered to by all parties involved in any takeover or merger transaction*" (Securities Commission) while detailed requirements are provided in the TOM Rules 2016. The original 1987 Code was substantially influenced by the English takeover law and regulatory framework (Mushera, 2013) which promotes the EOR. When the Australian Eggleston[1] and Masel[2] Principles (Mushera, 2010) were incorporated into the Malaysian takeover regime via S. 217(5) CMSA, the EOR from the 1987 Code remained preserved in the same section. In 2015, S. 217(5) CMSA was repealed but both the EOR and the Eggleston Principles were preserved in the 2016 Code. The EOR can be found in GP 1 of the 2016 Code which requires persons involved in takeover offer to provide equal treatment to all shareholders of an offeree of the same class in relation to a take-over offer and opportunities to participate in benefits accruing from the takeover offer, including in the premium payable for control. Such preservation is the main reason why Malaysian takeover laws have mandatory offer despite it adopts Australian takeover law objectives which do not apply mandatory offer.

## SOCIAL BENEFITS OF THE EQUAL OPPORTUNITY RULE

The social benefits of the EOR lies in the definition of "opportunity" or "treatment" which the acquirer has to equally grant to all shareholders of a same class in the target company during takeover proceedings. It refers to at least 4 important rights of shareholders as follows:

### Exit Right

When change of control is triggered when an acquirer gained shares in a company of specific percentage, the remaining

[1] Eggleston Principles:
1) The holders of shares in a company:
   a) know the identity of any person who proposes to acquire a substantial interest in the company;
   b) have a reasonable time to consider any proposal to acquire their shares; and
   c) are given enough information to allow them to consider the merits of any proposal to acquire their shares.
2) As far as practicable, all shareholders have a reasonable and equal opportunity to participate in any benefits accruing to shareholders through a proposal under which a person would acquire a substantial interest in the company.

[2] Masel Principle: The acquisition of control over the shares in a company takes place in an efficient, competitive and informed market.

shareholders should be granted an equal right of disinvestment. This right is given to the remaining shareholders by an imposition against the acquirer requiring that a mandatory general offer to minority shareholders the bought out right upon fulfilment of certain preconditions be made.

**Mandatory Offer.** Mandatory offer or bid is a compulsory requirement imposed on an acquirer to make a general offer to purchase the remaining issued voting shares or rights of the company which are not yet his. Due to this specific meaning, we are of the view that it is inaccurate to equate Mandatory Offer with the EOR since it is only one of the "opportunities" that the acquirer is required to give the remaining shareholders during takeover proceedings. The philosophy behind mandatory offer is mainly to protect the interest of minority shareholders but at the same time while also allowing the acquirer an opportunity to secure 100% control over the company (Mushera, 2013). Unlike a voluntary offer in which the offeror is generally at liberty to determine the terms of the offer, the terms of a mandatory offer are dictated by law.

**Bought Out Right.** The bought out right refers to minority shareholders' right which correspond to acquirer's right of compulsory acquisition. Under UK and Malaysian law, an acquirer who had successfully secured interest in at least 90% of the target company's voting shares or rights through takeover offer is given an option to compulsorily acquire the remaining 10% voting shares or rights so as to gain 100% control over the target company. On the contrary, the bought out right is given to minority shareholders to "force" the acquirer to purchase the remaining 10% voting shares or rights so that they may exit from the company if the acquirer did not exercise his compulsory acquisition right. The social benefits of equal exit right through mandatory offer or bought out right may be understood from the rationale that a shift of control changes the nature of investment of the existing shareholders via the following means (Jennings, 2005):

(a) the acquisition of control in a company without a dominant shareholder may lead to a major chang in the organisation and management of the company. As per the *status quo*, the company's affairs are managed by the incumbent management, with no one shareholder being able to employ pressure over the decision making process. When an acquirer gained control, he is capable of procuring that the company is manage in accordance with his wishes;

(b) the new controller may set up a different corporate agenda, which present the prospect that the company will be run to suit the acquirer's objectives;

(c) there is probability that the company will be managed to the disadvantages of the minority shareholders both in terms of a reduced shares' value and fraud on the minority. The position of minority shareholders would be even worse if the acquirer's intention is actually to "loot" the company by stripping it of any valuable assets; and

(d) the new controller may even decides to privatise the company which make the shares of the company illiquid. This make it difficult for the minority shareholders to liquidate their investment after the target company is privatised.

Such changes in the nature of investment may happen against the wishes of the minority shareholders, removing the choice factor of their original investment in the target company. In this regard, the exit right reinstates the minority shareholders' choice so that they may decide whether to remain in the minority or leave the company. Further, in pre-empting prospective harm or injurious behaviour by the new controller the aim of the EOR in providing an exit is to prevent the minority from coming into existence on an acquisition of control without their will (Jennings, 2005).

**Right to Premium**

The second right arising from the EOR requires all shareholders of the same class in the target company to be entitled to an equal amount of premium paid by the acquirer in consideration of control. This is often referred to as the "Sharing Rule" i.e. any premium the acquirer pays to the blockholder also has to be offered to the remaining shareholders, forcing the blockholder to share "his" premium with his fellow shareholders (Schuster, 2010). Due to this specific meaning it is inaccurate to equate it with the EOR since it is only one component of the EOR. In Malaysia the right to equal premium is one of the objectives of the 2016 Code as stated in its GP 1.

Shares are typically acquired at premium during a takeover because control over the corporation is a valuable "commodity" and brings with it the power to harness the activities of the company (Jennings, 2005). Furthermore, the premium paid by the acquirer corresponds to the value that the acquirer believes the target company possesses or at least its future. Equal opportunity to premium protects the target company's shareholders from the perspective that the potential harms which follows from a shift in control may give minority shareholders no choice but to leave. In such events, minority shareholders are at the mercy of the acquirer who can decide to sell their shares at the price determined by the acquirer or remain as minority and face the potential harms from the takeover.

In order to prevent the acquirer from having an upper hand in the deal, the law interferes takeover proceedings by not merely providing an exit opportunity but also regulates the terms through which the exit opportunity is exercised. Thus, it is incumbent upon an acquirer in a mandatory offer, compulsory acquisition, or bought out, to provide consideration equivalent to what he has paid for shares that he acquired within certain period prior to the making of the mandatory offer, compulsory acquisition or bought out.

**Mandatory Offer.** In the UK, consideration for mandatory offer is governed under Rule 9.5(a) City Code and in Malaysia, the equivalent provision are GP 10 of the 2016 Code and Rule 6.03(a) TOM Rules 2016. Both jurisdictions require that a mandatory offer must not be less than the highest price paid or offered to be paid by either the acquirer or person acting with concert with him for any voting shares or right to which the offer relates within the period of 12 months in the UK or 6 months in Malaysia prior to the mandatory offer. In addition, such consideration shall be paid in cash or if it is not solely in cash, the acquirer shall provide an alternative consideration of solely a cash sum[3].

**Compulsory Acquisition.** As discussed, both the UK and Malaysia provide means for an acquirer to gain 100% control over the target company via compulsory acquisition. Due to its sensitivity as it involves interference with the minority shareholders' right to property, the compulsory acquisition right was inserted into the parent acts itself rather than merely in the takeover codes, which are subsidiary legislations. S. 979(2) read together with S. 981(2) UK Companies Act 2006 provides that in compulsory acquisition, upon the giving of notice to the holder of shares by the acquirer on his intention to compulsorily acquire those shares, the acquirer is "*entitled and bound to acquire the shares to which the notice relates on the terms of the offer*". Hence, the acquirer is bound to provide consideration which is similar to the consideration offered in the previous takeover offer to which the compulsory acquisition relates. The Malaysian equivalent provisions on consideration for compulsory acquisition of shares are S. 222(1) read together with S. 222(3) CMSA which in effect is similar to those in the UK.

**Bought Out.** The legal requirement on consideration for bought out in the UK and Malaysia is similar to that of compulsory acquisition. Pursuant to S. 983 read together with S. 985(2) UK Companies Act 2006 for the UK and S. 223(1) CMSA for Malaysia, the consideration in bought out must be the similar as per the previous takeover offer to which the bought out relates. Nevertheless, the parties are allowed to mutually agree on other considerations.

**Right to Information**

Most writers discussed the EOR from the perspective of the exit right and the right to premium only. However, in our view, the rule is also relevant to the right to obtain information on a takeover offer. Disclosure of information is essential to enable shareholders to make proper assessment on whether to accept an offer (Mushera, Azza, Sharon, & Azhana, 2013) while inadequate information might lead to shareholders accepting an offer at a price

[3] Rule 9.5(a) City Code and Rule 6.04(1) TOM Rules 2016.

substantially below the actual price of the shares as happened in the UK in 1950s that triggers hostile takeovers. In this respect, the EOR applies by ensuring each and every shareholder of the target company receives information relating to the takeover so that they can make their own evaluation and decision.

The second GP of the City Code requires the offeree shareholders being given sufficient time and information to enable them to consider the takeover offer and arrive at a properly informed decision. Similarly, GP 5 of the 2016 Code requires all parties in a takeover or merger to make full and prompt disclosure of all relevant information while GP 6 of the 2016 Code requires the shareholders and the board of directors of an offeree and the market for the shares that are the subject of a takeover offer be provided with relevant and sufficient information, including the identity of the acquirer or offeror, to enable them to reach an informed decision on the takeover offer. Further, GP 8 of the 2016 Code prohibits an offeror, the board of directors of an offeror, the board of directors of an offeree and their respective advisers from making selective disclosure to the shareholders in the course of a take-over or merger transaction.

The law imposes several obligations on acquirer and directors of the target company in ensuring that none of the target company's shareholders are deprived of the right to make comprehensive assessment on an offer. An acquirer is required to make an announcement on the offer that it proposes and ensure that the information supplied to the target company's shareholders in the offer document is sufficient to allow them to make informed decision.

**Announcement.** Rule 2.2 City Code lists several circumstances in which announcement concerning a takeover offer should be made. The announcement is subject to conditions under Rule 2.7 City Code that the acquirer should announce the intention to make an offer only after careful and responsible consideration and when the offeror has every reason to believe that it can implement the offer. In Malaysia concerning this matter are enumerated in Rule 9 TOM Rules 2016.

**Offer Document.** The law dictates the contents of a takeover offer document. The obligation to insert specific information in the takeover offer in the UK is found in Rule 24 City Code. Among the information required is information on the acquirer, the terms of the offer, all conditions to which the offer is subject, the acquirer's intentions with regard to the future business and assets of the target company and the continued employment of the employees and management of the target company and of its subsidiaries. In Malaysia, the offeror is required under GP 6 of the 2016 Code to disclose to the shareholders and the board of directors of an offeree and the market on the shares that are the subject of a takeover offer, relevant and sufficient information to enable them to reach an informed decision on the takeover offer. Further, Rule 11.02 TOM Rules 2016 read together with Schedule 1 TOM Rules 2016 sets information on the offeror, the offeror's intention on the continuation of the business of the target company, the major changes that it would introduce, the maintaining of the listing status of the target company, the invoking of compulsory acquisition provision and the acquirer's intentions with regard to the future business and assets of the target company.

**Director's Comments.** The duty to provide information is not only imposed on the acquirer but also on the directors of the target company. In the UK, Rule 25 City Code states that the board of the target company must, within 14 days of the publication of the offer document, send a circular to shareholders of the target which shall set out, among others, the opinion of the board on the offer and the board's reasons for forming its opinion. In Malaysia, pursuant to Rule 11.03 TOM Rules 2016, the board of directors of the target company shall issue its comments, opinion and information on the takeover offer, including any other forms of consideration offered by the offeror, in a form of a circular to every target company's shareholders within 10 days from the date that the offer document was dispatched to the target company's shareholders. The circular shall also contain all information that the target company's shareholders and their advisers would reasonably require and expect to find for the purpose of making an informed assessment on the merits of accepting or rejecting the take-over offer.

**Independent Advice Circular.** Apart for issuing its own comments on the reasonableness of the takeover offer, the board of directors of the target is also required to appoint an independent advisor to evaluate and provide comments on the soundness of a takeover offer. This serves as check and balance on the role of the board and prevents abuse of position and conspiracy with the acquirer to recommend an unreasonable offer for the board's advantage. In the UK, Rule 3.1 City Code states that the board of the target company must obtain competent independent advice as to whether the financial terms of any offer are fair and reasonable and the substance of such advice must be made known to its shareholders. The Malaysian equivalent of the latter are GP 4 of the 2016 Code and Rule 3.06 TOM Rules 2016. The contents of the independent advice circular have to be consented by the SC prior to its issuance to the shareholders.

**Disclosure of Information by Directors of Target Company to Offeror.** It is interesting to note that in Malaysia regarding access to information that although the EOR is actually meant to protect minority shareholders' interest in takeover, the 2016 Code somehow has a unique feature which is not available in the UK where it extends the equal right to information to offerors. This unique feature is found in Rule 10.04 TOM Rules 2016 which indirectly benefits shareholders in creating competitive environment that helps shareholders to get the best offer for their shares.

**Right to Decide on a Takeover Offer**

All the above three rights lead to the final goal, the fourth right of ensuring shareholders of a target company are afforded with the right to be the actual decision makers on a takeover offer after having been given an opportunity to consider all relevant information. This can be found in the second GP of the City Code which requires the offeree shareholders be given sufficient time and information to enable them to make an informed decision. In Malaysia, GP 11 of the 2016 Code states, the board of directors of an offeree shall act in the interests of the shareholders as a whole and shall not deny the shareholders the opportunity to decide on a takeover offer. Further, GP 2 of the 2016 Code prohibit any form of oppression or disadvantage of shareholders by the treatment and conduct of the acquirer or of the board of directors of the offeree.

The exit right gives the shareholders the opportunity of divestment whereas the right to equal premium ensures that money did not become the shareholders' sole consideration in evaluating their investment in the target company. In addition, the right to information ensures the board of directors does not filter information on a takeover offer and decide on shareholders' behalf. The combination of these rights entitles shareholders to make a conscious decision on their prospective investment in the target company following takeover proceedings. Without such rights, offeree shareholders' right to be the actual decision maker is deprived. For instance, if there is no right to equal premium, they will be financially forced to accept whatever price offered by the acquirer hence money will become the sole determining factor in deciding whether or not to accept an offer.

## CONCLUSION

Based on the above discussion, it may be concluded that the social benefits of the EOR is in the form of various protections of shareholders' interests during takeover proceedings. Such influence can be seen at least in 4 primary aspects namely rights to disinvest, equal premium, information and make decision on a takeover offer. Ultimately, the rule is to allow shareholders of a target company to make an informed decision on whether or not to remain as shareholders in the target company. We have to admit that there is no man-made rule without flaws. Without undermining the criticisms made against the EOR,[4] there is a need to recognise that the EOR had, for more than 50 years governed takeover arena in the UK and Malaysia and successfully protected the interest of shareholders, especially the minority shareholders from the potential harms and oppression present in the shifting of corporate control. Although the EOR seems to favour shareholders in the offeree company compared to the acquirer, we believe that such is necessary because an acquirer always has an upper hand in term of economic capability as compared to shareholders especially individual shareholders in the offeree company. As

[4] See Balta, 2013; Schuster, 2010; Jennings, 2005; Mushera et al., 2013.

shareholders represent a larger segment of the society compared to acquirers, the rule that favours the majority will directly benefit society should prevail. Hence, we believe the application of such rules should be preserved in Malaysian law.

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