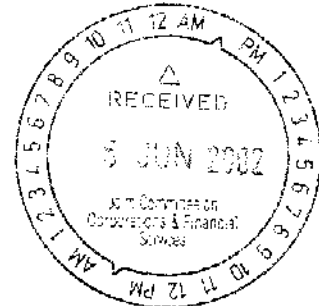


# Freehills

3 June 2002

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Dr Kathleen Dermody  
Secretary  
The Parliamentary Joint Committee  
on Corporations and Financial Services  
Parliament House  
CANBERRA ACT 2600



Dear Dr Dermody

## Proof transcript of evidence

Thank you for sending to me the copies of the proof Hansard transcript of evidence with respect to our appearance before the Committee on 23 May 2002.

On the basis that I am merely correcting errors in the transcription of what I actually said, I have very little comment. The only correction I would suggest is that to refer to "stapled" security rather than to "staple" security on CFS 19 and 26.

Otherwise, while it would have been nice to have been able to shorten some of my sentences, one has to accept them as the way in fact one actually talked.

On another aspect, I did say that I would send to the Committee something on the telephone monitoring of takeovers. I am enclosing a note written by two of my partners and a solicitor, which is on our website and dated 25 February 2002.

I am also enclosing a copy of an article on the subject written by the same partners and solicitor. It appeared in the CCH publication *Australian Corporate News* Issue No. 8 of 24 April 2002, pages 89-92. I hope that these attachments will assist the Committee. I actually mentioned one of my partners, although the material has not been written by him specifically.

It occurred to me further, after the question about how to handle the complexity of the regulations, that one particular problem I referred to before the Committee might be dealt with in the following way. It is the problem which appears in the transcript at the bottom of CFS 18, in the last paragraph, namely, that for the purposes of the transitional provisions, there are a number of specific regulations which provide for a "regulated principal", being the holder of an old securities dealer's licence to be included in a reference to the requirement to hold a financial services licence under the new provisions, so that there is relief for the transitional period.

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There have been gaps in provisions of that type which mean that the existing holders of old securities dealer's licences still relying on them under the transitional provisions do not have the benefit of an exemption or other treatment which is applied only to a financial services licensee, for the transitional period.

I am not aware of any good reason why there should not be a general provision under which, wherever a regulation or other requirement gives a special treatment if a financial services licence is held, that should not also taken to refer to the holder of an appropriate old securities dealer's or futures brokers licence. An example is Regulation 7.1.33B which I contrasted with Regulation 10.2.39. Another is the reference to a financial services licensee in sections 911B(1)(d) and 911B(3).

With kind regards

Yours sincerely

A handwritten signature in cursive script that reads "Don Harding". The signature is written in black ink and is positioned to the right of the typed name "Prof. Don Harding".

Prof. Don Harding



# ACN

# AUSTRALIAN CORPORATE NEWS

Issue No 8

24 April 2002

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## TAKEOVERS

### Telephone monitoring in takeovers

*Telephone monitoring requirements now apply to bidder and target companies in company takeovers. These requirements are onerous and will require participants to be well prepared before any telephone canvassing of shareholders can commence.*

By inserting takeover telephone monitoring requirements into the *Corporations Act 2001* as part of the Financial Services Reform Program, Parliament has placed onerous and expensive obligations on bidder and target companies who talk to shareholders during the course of a takeover bid.

The telephone monitoring provisions, which commenced on 11 March 2002, are designed to increase protection for small shareholders from misleading or deceptive conduct where the bidder or target (themselves or through professional communications consultants) contact shareholders to determine the shareholders' response to the bid. However, the result of including these provisions is likely to have a much wider application than the legislature intended.

The provisions were not included in the exposure draft of the Financial Services Reform Bill (FSRB), and hence have not been subject to a great level of public scrutiny. In particular,

the requirement to record incoming calls was not even contained in the initial FSRB, but was introduced at a later stage.

### The requirements

The provisions will require a bidder or target (known as a recorder) to make a tape recording of all outgoing telephone calls to a shareholder (and all incoming calls if these calls are "invited"), which are made during the bid period, to discuss the takeover bid.

There are highly prescriptive procedures a recorder must follow — they must verbally notify the holder that the call is being recorded (a beeping signal will not be sufficient) and recordings will need to be appropriately identified, indexed and stored for 12 months following the close of the bid period.

Importantly, the index and recordings must be destroyed one day after the 12 months expires — failure to do so will, in and of itself, constitute an offence.

The provisions refer to the new Criminal Code for determination of liability. Interestingly, although the new corporate criminal responsibility provisions apply to the telephone monitoring provisions, they do not apply to the new Ch 7 governing financial services.

### The carve-out

The requirement will not apply to telephone calls with shareholders who are classed as "wholesale holders". Broadly, these are shareholders who hold securities with a value of at least \$500,000; have net assets of \$2.5 million or gross income of \$250,000; or are professional investors (which is defined to include, amongst other things, financial service licensees and listed entities). In practice, these tests would most likely only exclude institutions.

In addition, regulations released on 15 February 2002 now prescribe directors,

executive officers and authorised representatives of financial services licensees as "wholesale holders" for the purposes of the provisions. This change means that a bidder or target can now telephone directors, senior management and their financial advisers about the bid without triggering the provisions just because they happen to hold shares.

However, the financial services licensee carve-out appears not to provide universal protection for financial services licensees. For example, the carve-out applies only to "authorised representatives" of financial services licensees, and hence will not automatically apply to employees and directors of financial services licensees who will usually be "representatives" rather than "authorised representatives". In addition, the carve-out will not apply to financial advisers who do not hold a financial services licence under the new regime, but are relying on the transitional provisions in respect of a licence held under the old regime (for example, a dealer's licence). We are hopeful that these apparent defects will be remedied in the near future. Until this time, however, it may be necessary for financial advisers to seek relief on a case-by-case basis.

A further practical issue for a recorder is what level of proof is required to satisfy themselves that a shareholder is a "wholesale shareholder". Presumably, as for prospectuses, a representation in writing would be a minimum.

### The issues

A pivotal question is what constitutes an "invitation" to shareholders to call for the purposes of discussing the bid. It seems clear that the establishment and advertisement of an infoline will be classed as an invitation. But what if an adviser puts their name on a bidder's statement? Or an independent expert?

If these constitute an invitation, the ramifications could be dramatic. It would mean

that all advisers to a bidder or target company would be required to install recording facilities and retrain their staff — or turn away shareholders who make such enquiries.

It would seem that merely putting one's name on a takeover document does not constitute an invitation. However, if the name is accompanied by a telephone number, it may be construed as such. Importantly, for advisers such as investment banks, this will also apply to press releases which, typically, would contain such details. As the legislature has not defined what constitutes an "invitation", it will be interesting to see the approach adopted by the courts on this issue.

It is understood that ASIC is preparing a policy on this issue, which should be released in the coming weeks.

### The anomalies

The legislation also has a raft of anomalies. For example:

- the provisions only relate to calls during the bid period which, for an off-market bid, commences when the bidder's statement is served on the target (not when the bid is announced). This means that a bidder could quite easily contact shareholders to promote the offer between announcement and service of the bidder's statement without attracting the new rules;
- the provisions only apply to telephone recordings — no similar provisions exist if shareholders are contacted in person or by other means;
- although financial advisers to a bidder or target are carved out of the requirement (subject to our comments above), there is no such relief for advisers such as lawyers or media consultants. Accordingly, for example, if the bidder or target calls their lawyer to discuss the bid, and the lawyer holds shares in the target, the call will have to be taped; and

- the provisions only relate to the holder of shares. Thus, a bidder speaking to a beneficial holder of shares who holds their shares through a nominee would not be caught by the requirements.

### Onerous nature of provisions

The Explanatory Memorandum to the FSRB indicates that Parliament was aware of the costs associated with training of staff, provision of recording devices, and identification and storage of the records. However, Parliament adopted the view that these costs were offset by the additional protection provided to small shareholders and the cost savings the recorders would realise in not having to endure costly legal disputes on potentially misleading and deceptive actions.

Parliament has not provided any details on these supposed cost savings. More to the point, these provisions might actually give rise to a greater number of spurious claims, significantly increasing ASIC's costs in having to sort through and listen to recordings.

In addition to the financial costs of compliance, the provisions make the mechanics of a takeover significantly more clumsy. Companies who speak to shareholders may be reluctant to have entire conversations (across a variety of issues) taped, and so may be required to make separate calls to shareholders when they want to discuss the takeover bid.

As advisers are unlikely to install expensive recording equipment, it is likely that infolines will no longer refer shareholder questions directly to professional advisers. Instead, answers to shareholders will need to be obtained offline, with infoline staff calling shareholders back with the answer — a far from efficient method, particularly where follow-up questions are required.

Finally, the provisions make no allowance for mobile phones. Effectively, no calls can be

made to shareholders using a mobile phone during a takeover bid, as they will be unable to be recorded.

One of the guiding principles of the takeover provisions is that shareholders be given enough information to enable them to assess the merits of the proposal. It is difficult to see how the new provisions are consistent with this principle. Any bidder, target or adviser who either cannot afford or cannot establish the new facilities will not be able to discuss a takeover bid with shareholders — and will have to turn them away.

### In conclusion

There will always be occasions when shareholders will seek further information. Takeover documents are generic and designed to meet the legal disclosure requirements, not provide all the information every shareholder may desire. As such, to put bidders or targets in the position of being potentially unable to answer these queries over the telephone seems to conflict with a fundamental tenet of takeover law.

*This article was written by Rodd Levy and Aaron Kenavan, Partners, Freehills Sydney and Damien Bruce, Solicitor, Freehills Melbourne.*

### Compulsorily acquiring worthless shares

*According to a recent Federal Court case, it is not necessary for securities to have some value before they can be compulsorily acquired under the compulsory acquisition provisions.*

In this case, Resource Surveys held 40 million options (comprising three different classes) entitling it to subscribe for 40 million fully paid ordinary shares in New Hampton. Harmony Gold, through its Australian subsidiary, acquired 96.5% of the shares in New Hampton and took steps to compulsorily acquire the options held by Resource Surveys for a cash

price of \$1.00, contending that the options were worthless. Resource Surveys contended that the notices of compulsory acquisition in respect of the different classes of options were invalid because the terms of payment for the options (\$1.00 for all the options in each class) did not comply with sec 664B(1).

*Finkelstein J* held that it is not necessary for securities to have some value before they can be compulsorily acquired under the compulsory acquisition provisions of the *Corporations Act*. While it is true that there is a requirement that the 90% holder pay cash for the securities acquired (see sec 664B(1)), the amount paid can be a nominal sum in a case where the securities have no value. The fact that an arithmetical calculation shows that the purchase price, when attributed to each individual security, is not in a payable sum is not relevant because there is no obligation to make a separate payment for each security.

A further issue arose in the case as to the adequacy of the compulsory acquisition notice required under sec 664C(1)(c). *Finkelstein J* held that it is not necessary that the notice provide a summary of all the provisions of Pt 6A.2. The notice must however give enough information about the compulsory acquisition procedure so that its general effect can be understood. *Finkelstein J* criticised the approved form for the notice of compulsory acquisition, ASIC approved form — Form 6024. Because the approved form contained no reference to the deeming provision in sec 664C(4) (deemed delivery of notice three days after notice posted), it had the potential to mislead. The recipient is likely to assume that time started running from the date on which he or she actually received the notice; which may not be three days after the notice was posted.

*Re New Hampton Goldfields; Resource Surveys Pty Ltd v Harmony Gold (Australia) Pty Ltd* [2002] FCA 391. Fed Ct of Aust (*Finkelstein J*, 5 April 2002). To be reported in (2002) 20 ACLC.

## Publications

### Telephone monitoring in takeovers

25 February 2002

Telephone monitoring requirements are about to apply to bidder and target companies in company takeovers. These requirements are onerous and will require participants to be well-prepared before any telephone canvassing of shareholders can commence.

In inserting takeover telephone monitoring requirements into the Corporations Act as part of the Financial Services Reform Program, Parliament has placed onerous and expensive obligations on bidder and target companies who talk to shareholders during the course of a takeover bid.

The telephone monitoring provisions, due to commence on 11 March 2002, are designed to increase protection for small shareholders from misleading or deceptive conduct where the bidder or target (directly or through professional communications consultants) contact shareholders to determine the shareholders' response to the bid. However, the result of including these provisions is likely to have a much wider application than the legislature intended.

The provisions were not included in the exposure draft of the Financial Services Reform Bill (FSRB), and hence have not been subject to a great level of public scrutiny. In particular, the requirement to record incoming calls was not even contained in the initial FSRB, but was introduced at a later stage.

#### The requirements

The provisions will require a bidder or target (known as a **recorder**) to make a tape recording of an outgoing telephone calls to a shareholder (and an incoming call if those calls are 'invited'), which are made during the bid period, to discuss the takeover bid.

There are highly unscrutinised procedures a recorder must follow - they must verbally notify the holder that the call is being recorded (a beeping signal will not be sufficient) and recordings will need to be appropriately identified, indexed and stored for 12 months following the close of the bid period.

Importantly, the index and recordings must be destroyed one day after the 12 months expires - failure to do so will, in and of itself, constitute an offence.

The provisions refer to the new Criminal Code for determination of liability. Interestingly, although the new corporate criminal responsibility provisions apply for the telephone monitoring provisions, they do not apply to the new Chapter 7 governing financial services.

#### The carve-out

The requirement will not apply to telephone calls with shareholders who are classed as 'wholesale holders'. Broadly, these are shareholders who hold securities with a value of at least \$500,000, have net assets of \$1.5 million or gross income of \$250,000; or are professional investors (which is defined to include, amongst other things, financial service licensees and listed entities).

In practice, these tests would most likely only exclude institutions.

In addition, regulations released on 15 February 2002 now prescribe directors, executive officers and authorised representatives of financial services licensees as 'wholesale holders' for the purposes of the provisions. This change means that a bidder or target can now telephone directors, senior management and their financial advisers about the bid without triggering the provisions just because they happen to hold shares.

However, the financial services licensee carve-out appears not to provide universal protection for financial services licensees. For example, the carve-out applies only to "authorised representatives" of financial services licensees, and hence will not automatically apply to employees and directors of financial services licensees who will usually be "representatives" rather than "authorised representatives". In addition, the carve out will not apply to financial advisers who do not hold a financial services licence under the new regime, but are relying on the transitional provisions in respect of a licence held under the old regime (for example, a dealer's licence). We are hopeful that these apparent defects will be remedied in the near future. Until this time, however, it may be necessary for financial advisers to seek relief on a case-by-case basis.

A further practical issue for a recorder is what level of proof is required to satisfy themselves that a shareholder is a 'wholesale shareholder'. Presumably, as for prospectuses, a representation in writing would be a minimum.

#### The issues

The provisions raise some interesting issues.

##### *What is an 'invitation'?*

A pivotal question is what constitutes an 'invitation' to shareholders to call for the purposes of discussing the bid. It seems clear that the establishment and advertisement of an 'infoline' will be classed as an invitation. But what if an adviser puts their name on a bidder's statement? Or an independent expert? If these constitute an invitation, the ramifications could be dramatic. It would mean that all advisers to a bidder or target company would be required to install recording facilities and retrain their staff - or turn away shareholders who make such enquiries.

It would seem that merely putting one's name on a takeover document does not constitute an invitation. However, if the name is accompanied by a telephone number, it may be construed as such. Importantly, for advisers such as investment banks, this will also apply to press releases which, typically, would contain such details. As the legislature has not defined what constitutes an 'invitation', it will be interesting to see the approach adopted by the courts on this issue. It is understood that ASIC is preparing a policy on this issue, which should be released in the coming weeks.

##### *Anomalies*

The legislation also has a raft of anomalies. As examples:

- the provisions only relate to calls during the bid period which, for an off-market bid, commences when the bidder's statement is served on the target (not when the bid is announced). This means that a bidder could quite easily contact shareholders to 'promote' the offer between announcement and service of the bidders statement without attracting the new rules;
- the provisions only apply to telephone recordings - no similar provisions exist if shareholders are contacted in person or by other means;
- although financial advisers to a bidder or target are carved out of the requirement (subject to our comments above), there is no such relief for advisers such as lawyers or media consultants. Accordingly, for example, if the bidder or target calls their lawyer to discuss the bid, and the lawyer holds shares in the target, the call will have to be taped; and
- the provisions only relate to the 'holder' of shares. Thus, a bidder speaking to a beneficial holder of shares who holds their shares through a nominee would not be caught by the requirements.

##### *Onerous nature of provisions*

The Explanatory Memorandum to the FSRB indicates that Parliament was aware of the costs associated with training of staff, provision of recording devices, and identification and storage of the records. However, Parliament adopted the view that these costs were offset by the additional protection provided to small shareholders and the cost savings the recorders would realise in not having to endure costly legal disputes on potentially misleading and deceptive actions. Parliament has not provided any details on these supposed 'cost savings'. More to the point, these provisions might actually give rise to a greater number of spurious claims, significantly increasing ASIC's costs in having to sort through and listen to recordings.

In addition to the financial costs of compliance, the provisions make the mechanics of a takeover significantly more clumsy. Companies who speak to shareholders may be reluctant to have on-line conversations (across a variety of issues) topics, and so may be required to make separate calls to shareholders when they want to discuss the takeover bid.

As advisers are unlikely to install expensive recording equipment, the likelihood that "hotlines" will no longer refer shareholder questions directly to professional advisers. Instead, answers to shareholders will need to be obtained offline, with "hotline" staff cycling shareholders back with the answers via a more indirect method, particularly where follow-up questions are required.

Finally, the provisions make no allowance for mobile phones. Effectively, no calls can be made to shareholders using a mobile phone during a takeover bid, as they will be unable to be recorded.

#### *Provision of information to shareholders*

One of the guiding principles of the takeover provisions is that shareholders be given enough information to enable them to assess the merits of the proposal. It is difficult to see how the new provisions are consistent with this principle. Any bidder, target or adviser who either cannot attend or cannot establish the new facilities will not be able to discuss a takeover bid with shareholders - and will have to turn them away.

#### **Conclusion**

There will always be occasions when shareholders will seek further information. Takeover documents are generally designed to meet the legal disclosure requirements, not provide all the information every shareholder may desire. As such, to put bidders or targets in the position of being potentially unable to answer these queries over the telephone seems to conflict with a fundamental tenet of takeover law.

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