

Chapter 3

Issues raised in evidence

3.1 As a result of the *Glencore* decisions, concerns have been raised that it may be possible to read the Panel's powers and jurisdiction in a way that is too narrowly formulated to enable the Panel to effectively perform its role. According to Treasury officials the bill is intended to remove the uncertainty raised by *Glencore* about the future effectiveness of the Panel:

...the *Glencore* case has raised doubts as to whether the panel was going to be able to continue to effectively fulfil the role intended for it, that is, to act in an informal, expeditious way without being unduly technical or legalistic. It was to address those concerns that the bill was designed.¹

3.2 The bill proposes several changes to the *Corporations Act 2001* (the Act) that seek to address the perceived problems created by *Glencore* including:

- definition of 'substantial interest';
- broadening the 'effect' test; and
- submissions from affected persons.

3.3 The issue of the appropriate disclosure of equity derivatives, which to some extent falls outside the scope of this bill, is also considered.

Definition of 'substantial interest'

3.4 The bill proposes the introduction of a definition of the term 'substantial interest' which is currently not defined in the Act. As a result of the committee's inquiry and stakeholders' comments, modifications have been made to the definition of 'substantial interest' that appears in the bill. It is important to note that the evidence that appears below on the 'substantial interest' concept relates to the definition that appeared in the exposure draft rather than the bill itself. The committee has not received any evidence relating to the revised definition.

A broad definition

3.5 The definition itself does not attempt to place limits or give any direct guidance on what is encompassed by the term. Instead, it states that:

...a **substantial interest**...is not to be read as being limited to an interest that is constituted by one or more of the following: a relevant interest...; a legal

1 Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury, *Committee Hansard*, 1 December 2006, p. 23.

or equitable interest...; a power or right in relation to company, body or scheme or securities in the company, body or scheme.²

3.6 The Treasury's submission explained the rationale for this indirect approach:

The approach taken in the [bill] allows a flexibility which is consistent with the role of the Takeovers Panel and its case-by-case approach. A more comprehensive definition may result in problems when market practices change and would be inconsistent with a principles-based approach to drafting. It would probably be impossible to frame a completely comprehensive definition of 'substantial interest', even if that were considered desirable.³

3.7 Mr McKeon explained to the committee the practical, anti-avoidance reason for including an indirect definition of 'substantial interest':

The difficulty is that as soon as we introduce a defined version of what 'substantial interest' means, the very next minute takeover practitioners will be trying to define something or create something that falls very neatly outside it. That is the very reason we would say that one needs to be very careful about putting in place a comprehensive definition of 'substantial interest'.⁴

3.8 Mr Morris, the Director of the Panel, elaborated on Mr Keon's comments:

...the definition is not all that helpful, either to the courts or, as Mr McKeon said, to people looking to walk their way around it. We think it is a good idea to leave it as an open concept that will grow and develop as takeover techniques and instruments grow and develop over time. If we start trammelling it with black-letter law definitions, we do not think that will be helpful to the regulation of takeovers. The definition will then need updating and amending every time someone comes along and thinks up a new takeover technique or instrument.⁵

3.9 Treasury officials also provided a similar explanation:

The rationale was that a substantial interest should not be confined to a narrower relevant interest. The understanding of substantial interest has never been defined in the statute and it has proved capable of interpretation on the normal meaning of the words since then. The rationale was to prevent a more restrictive interpretation prevailing but to leave open the issue of what might or might not qualify as a substantial interest. Because this is an area where you are constantly getting new devices, new instruments and new machinery that might operate in a slightly different

2 Corporations Amendment (Takeovers) Bill 2007, new sections 9 and 602A.

3 Department of the Treasury, *Submission 6*, p. 2.

4 Mr Simon McKeon, President, Takeovers Panel, *Committee Hansard*, 1 December 2006, p. 7.

5 Mr Nigel Morris, Director, Takeovers Panel, *Committee Hansard*, 1 December 2006, p. 7.

way or get around particularly prescriptive wording, it was felt best to leave the question slightly open.⁶

Increased uncertainty

3.10 The proposed definition of 'substantial interest' that appeared in the exposure draft was criticised by many submitters for introducing a new dimension of uncertainty into the takeovers process. For example Mr Kriewaldt and Mr Hartnell jointly submitted that the definition is 'not a definition but a non-definition,...substantially increases uncertainty,...[and]...invites the Panel to invent its own jurisdiction'.⁷ They pointed out that the breadth of the definition creates a risk that the Panel may ignore existing regulatory constraints imposed by the Parliament:

...for example, Parliament has said in section 609 that there are things that don't cause it any problems and so they are not to be treated as relevant interests (eg nominee holdings, etc), why should they be allowed to found a risk of unacceptable circumstances declarations.⁸

3.11 The Australian Institute of Company Directors (AICD) also criticised the definition as 'capable of both uncertain interpretation and application'.⁹ The key issue in the AICD's view is that a 'significant interest' must relate to securities of the relevant company but need not be confined to a 'relevant interest'.

3.12 Mr Shaw, who has previously acted as legal counsel to the Panel during the *Glencore* review, argued that 'introducing a new concept may have unintended consequences that will perhaps require yet more legislative intervention'.¹⁰

3.13 Commentators also questioned the proposed definition as it explains what a 'substantial interest' *is not* but not what a 'substantial interest' is:

It's difficult to see how [new section 602A is] a definition. It essentially provides that a substantial interest can be whatever the panel determines it to be in relation to the circumstances that it is considering. Such a provision would be likely to introduce an undesirable degree of uncertainty with companies and their advisers trying to second-guess the probable response of the panel.¹¹

6 Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury, *Committee Hansard*, 1 December 2006, p. 25.

7 Mr Jeremy Kriewaldt and Mr Tony Hartnell, *Submission 2*, p. 14.

8 Mr Jeremy Kriewaldt and Mr Tony Hartnell, *Submission 2*, p. 14.

9 Australian Institute of Company Directors, *Submission 1*, p. 1.

10 Mr Alan Shaw, *Submission 1*, p. 2.

11 Mr Bryan Firth, 'Election puts puff into rewriting Takeover Panel's powers', *The Australian*, 20 September 2006, p. 38.

3.14 The Law Council of Australia submission raised a practical issue that results from the breadth of the definition. It stated that the proposed definition could easily be read to cover interests in a company that do not concern rights relating to securities, such as those of employees, customers and suppliers, which it said is clearly inappropriate.¹²

3.15 Treasury officials responded that the policy intention is for the definition not to cover rights relating to employees, customers and suppliers:

...the draft would not allow those interests to be covered. The bill will be revised by the Office of Parliamentary Counsel before it is introduced and it may be that it is possible to amend the drafting in such a way that it is clearer.¹³

3.16 The Panel also responded that creating an express exemption for employees, customers or suppliers would be unnecessary:

The suggestion that the Panel would, or could, inappropriately assert jurisdiction over matters unrelated to takeovers ignores past experience and the fact the Courts will inevitably interpret the definition having regard to its context (Chapter 6) and subject matter (takeovers).

...we consider that introducing express exceptions to the definition would be undesirable because they run the risk of creating (or even signposting) 'loopholes' that can be exploited to avoid the requirements and purposes of the Act.¹⁴

Addressing the 'mischief'

3.17 Another critical issue raised by the Law Council was that the proposed definition contained in the exposure draft does not appear to clearly provide the Panel with jurisdiction to address issues relating to disclosure of equity derivatives – the issue at the heart of the *Glencore* decisions and the very 'mischief' the bill is designed to address. The Law Council's submission argued that by their nature, equity derivatives do not create an 'interest' (in the proprietary sense of the word) in a company and therefore cannot give rise to a 'substantial interest':

If a person simply enters into an arrangement with someone to be paid a cash sum if the price of a particular company's shares increases, and neither party has any other interest whatsoever in those shares, *it is certainly not clear that the person has any 'interest' in that company*. That, in its simplest form, is the nature of an economic interest under an equity derivative. It may be no more than a punter having a bet.

12 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 3.

13 Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury, *Committee Hansard*, 1 December 2006, p. 25.

14 Takeovers Panel, *Supplementary Submission*, p. 1.

As observed by Emmett J in *Glencore*, something must first be found to constitute an 'interest' before it can be a 'substantial interest'...

An economic interest in share price movements resulting from market trading by others is not, on its own, a proprietary interest in a company or any shares of a company. Further, it is clearly arguable that it cannot be an 'interest' in a company in any legal sense, and therefore, *notwithstanding the breadth of the proposed definition, it cannot give rise to a substantial interest.*

For these reasons, the [Law Council] is concerned that if the Bill were enacted and the Panel thereafter made a declaration of unacceptable circumstances as a result of the failure of a person to disclose an equity derivative position held by them over 5% [or] more of a target, there is a *significant likelihood that the declaration could be challenged successfully on the basis that the interest of the derivative holder did not fall within the concept of substantial interest, notwithstanding the new definition.*

Therefore, there is real uncertainty as to whether the definition will achieve the policy objective in relation to disclosure of economic interests under equity derivatives.¹⁵

3.18 On this basis the Law Council recommended that the definition should be removed.¹⁶ In the Council's view the issue of the disclosure of equity derivatives should be dealt with under Chapter 6C of the Act, although not as part of the current amendment bill.¹⁷ This position was supported in evidence by the Financial Services Institute of Australasia (FINSIA), Mr Shaw, Mr Kriewaldt and Mr Hartnell.¹⁸

Further clarification

3.19 Despite the bill's indirect definition, there is provision (which did not appear in the exposure draft) for the introduction of regulations which could expressly include or exclude interests that would, or would not, constitute a 'substantial interest'.¹⁹

3.20 Furthermore, the Explanatory Memorandum provides guidance to the Panel and its stakeholders regarding what would constitute a 'substantial interest'. It makes clear that the definition is intended to be sufficiently broad to cover new and evolving instruments and developments in takeovers, which is presumably reference to equity derivatives and similar mechanisms. The memorandum states:

15 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, pp 4–5, emphasis added.

16 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 6.

17 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 6.

18 Financial Services Institute of Australasia, *Submission 5*, p. 3; Mr Alan Shaw, *Submission 1*, p. 2; and Mr Jeremy Kriewaldt and Mr Tony Hartnell, *Submission 2*, p. 13.

19 Corporations Amendment (Takeovers) Bill 2007, new subsections 602A(2) and (3).

The definition is intended to ensure that the term 'substantial interest' is broad enough to encompass new and evolving instruments and developments in takeovers and to deter avoidance of the purposes of the takeovers law.²⁰

3.21 The memorandum goes on to state there are limits to the definition, and gives the example of employee, suppliers and customers which would fall outside the definition:

It is not intended that every involvement with a company, listed body or listed managed investment scheme will be a substantial interest. By way of example, people will not have a substantial interest in a company merely because they are employees of the company, or supply goods or services to the company, or are someone to whom the company supplies goods or services.²¹

Committee view

3.22 As a general statement, the committee supports the role of the Panel as the main forum for the resolution of takeover disputes. It has become an effective arbiter and decision-maker in takeover disputes and has reduced the cost and improved the timeliness of resolving such disputes. However, the committee notes that the Panel is designated by the Parliament as the 'main' forum, not the exclusive or sole forum. Furthermore, companies involved in takeovers disputes should have the right to seek judicial review of Panel declarations to ensure that decisions are made according to the principles of administrative law.

3.23 The committee considers that companies launching, and involved in, complex takeovers processes are entitled to have a reasonable degree of certainty in planning their activities. If the meaning of 'substantial interest' is not clear this would raise the possibility of further disruptive litigation and subsequent legislative amendment. In the committee's view this outcome would be undesirable.

3.24 The committee agrees that the Panel should have the flexibility to respond to changing circumstances and the development of new instruments in the financial services sector, particularly in the rapidly evolving area of equity derivatives.

3.25 The committee shared the concerns raised by submitters regarding the open-ended definition that appeared in the exposure draft. However, the committee is pleased that the Government has provided further clarification in the Explanatory Memorandum and has also provided for regulations to be introduced to provide further certainty in this area. As a result, the committee considers that the changes that have been made should satisfy the concerns raised by submitters. The committee will maintain a close interest in developments in this area.

20 Explanatory Memorandum, p. 5.

21 Explanatory Memorandum, p. 5.

Broadening the 'effect' test

3.26 The bill proposes the two main changes to broaden the 'effect' test which is set out in paragraph 657A(2)(a):

- past, present and future effects; and
- new jurisdictional powers.

Past, present and future effects

3.27 The bill will empower the Panel to make a declaration or order where the Panel 'is satisfied' that the circumstances 'had, have, will have or are likely to have an effect...'²² According to the explanatory statement this will broaden the Panel's powers by allowing it:

...to take action to prevent likely future effects of circumstances which are brought before it, rather than being required to wait for the effects, and their consequent harm, to have occurred.²³

3.28 Mr Kriewaldt and Mr Hartnell, who represented the applicant in the *Glencore* cases, noted that there is nothing in those cases relating to present or future effects, but concluded that 'it is sensible to allow the Panel to act before harm is caused by taking account of likely future effects of current circumstances.'²⁴

New jurisdictional powers

3.29 The Panel will be empowered by the bill to make a declaration or order where it appears that the circumstances 'are otherwise unacceptable... having regard to the purposes of the [Takeovers provisions] set out in section 602.'²⁵ This change will broaden the Panel's jurisdiction by enabling it to declare circumstances unacceptable by reference to the objectives of the Takeovers Chapter of the Act.

3.30 In relation to the scope of the Panel's powers the Law Council submitted 'the Panel should have a broad-based jurisdiction, within constitutional limits, in order to discharge its functions without constant concerns about jurisdictional challenges.'²⁶

3.31 The breadth of this proposed provision was criticised by several submitters. For example the AICD warned of possible constitutional challenges:

The AICD is also concerned that the language of proposed new paragraph 657A(2)(b) will also give rise to undesirable uncertainty about the Panel's jurisdiction and that it could be vulnerable to constitutional challenge on the

22 Corporations Amendment (Takeovers) Bill 2007, new paragraph 657A(2)(a).

23 Explanatory Statement, Corporations Amendment (Takeovers) Bill 2006, 8 August 2006, p. 2.

24 Mr Jeremy Kriewaldt and Mr Tony Hartnell, *Submission 2*, p. 16.

25 Corporations Amendment (Takeovers) Bill 2007, new paragraph 657A(2)(b).

26 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 1.

basis that it is an attempt to give the Panel the power to define its own jurisdiction.²⁷

3.32 A more colourful criticism of the proposed amendment came from a newspaper which wrote that the amendment 'would give the panel carte blanche to run down any rabbit hole it chooses, even where the behaviour complained of had no demonstrable impact upon a takeover, as was the case in Austral Coal.'²⁸

3.33 During the hearings, representatives of the Panel rejected these concerns:

Although the wording of the power may appear to be broad, as Mr McKeon has explained, it is located within chapter 6, which deals with a very narrow area of practice—takeovers. The courts will read down any broad discretion having regard to its context, subject matter and the act. The courts will read this down if the panel starts to do things that are not related to takeovers, which is the subject matter of the chapter... We would suggest that it is better to have a power conferred in those terms that can be read down appropriately by the courts rather than trying to define jurisdiction in a very detailed and black-letter way.²⁹

3.34 Treasury officials also told the committee that it received advice from the Australian Government Solicitor that indicated that the proposed amendment would not provide grounds for a constitutional challenge.³⁰

3.35 Finally, the Law Council proposed a minor amendment to new paragraph 657A(2)(b) in order to 'ensure that the new power is firmly grounded in explicit policy considerations.'³¹ The Law Council proposal would essentially replace the phrase 'having regard to' with 'because they are inconsistent with or contrary to' the purposes set out in section 602. This proposal appears consistent with the commentary included in the Explanatory Memorandum which uses the phrase 'impair those purposes'.³²

3.36 The Treasury indicated in its submission that it is taking advice on this point, however this issue was not addressed during the public hearings.³³

27 Australian Institute of Company Directors, *Submission 1*, p. 2.

28 Mr Bryan Firth, 'Election puts puff into rewriting Takeover Panel's powers', *Australian*, 20 September 2006, p. 38.

29 Mr Bruce Dyer, Counsel, Takeovers Panel, *Committee Hansard*, 1 December 2006, p. 14.

30 Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury, *Committee Hansard*, 1 December 2006, p. 23.

31 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 5.

32 Explanatory Memorandum, p. 5.

33 Department of the Treasury, *Submission 6*, p. 3.

Committee view

3.37 The committee endorses the view of the Law Council that 'the Panel should have a broad-based jurisdiction, within constitutional limits, in order to discharge its functions without constant concerns about jurisdictional challenges.'³⁴ In the committee's view a provision such as the proposed paragraph 657A(2)(b) is an appropriate mechanism to achieve this goal.

3.38 The committee does not have the benefit of seeing the advice to Treasury, however it is supportive of the Law Council's proposed amendment. It is the committee's view that the Law Council's proposal is more closely linked to policy objectives contained in Chapter 6 and will provide greater certainty to the Panel and its stakeholders. The committee prefers the Law Council's more specific formulation to the general approach included in the bill.

Recommendation 1

3.39 The committee recommends that the Government introduce an amendment to new paragraph 657A(2)(b) to replace the phrase 'having regard to' with 'because they are inconsistent with or contrary to'.

Submissions from affected persons

3.40 Currently, before the Panel makes an order resulting from a finding of unacceptable circumstances, it must give each person to whom the order *relates* an opportunity to make a submission to the Panel about the matter.³⁵

3.41 In the second *Glencore* case the Federal Court agreed with the Panel's view that the Panel did not need to provide each person to whom an order *relates* the opportunity to make submissions if they would not be prejudicially affected by the order.

3.42 The bill proposes to give effect to that decision by only requiring an opportunity to submit to those to whom an order *would be directed*.³⁶ According to the explanatory statement the rationale for this change is 'there could be tens of thousands of such people in some cases, including each current and potential shareholder in the relevant companies.'³⁷

34 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 1.

35 *Corporations Act 2001*, para 657D(1)(a).

36 New paragraph 657D(1)(a).

37 Explanatory Memorandum, p. 6.

3.43 Concerns were raised by submitters such as the AICD who argued that the proposed change 'might unduly narrow the range of persons affected by a proposed order who would be entitled to an opportunity to make submissions to the Panel.'³⁸

3.44 Mr Kriewaldt and Mr Hartnell also raised the concern that this issue would depend on the Panel's drafting of the order. It gave the example:

...the order could be directed to a nominee holder and the Panel could make the order without hearing from the beneficiary or giving them an opportunity to be heard.³⁹

Committee view

3.45 In the committee's view this issue does not raise serious concerns. The committee accepts the practical consideration which underpins this proposed change. Furthermore, the provision does not appear to preclude the Panel from receiving and considering submissions from those persons to whom an order *relates*, even though it would not be required to do so. Accordingly the committee supports this amendment.

Equity derivatives

3.46 As noted in paragraph 3.18, although the proposed definition of 'substantial interest' seeks to allow the Panel to consider the effect of equity derivatives on a takeover, many submitters were of the view that further amendments are needed to ensure adequate disclosure of such arrangements. For example the Law Council submitted:

In light of the uncertainties highlighted in [relation to the definition of 'substantial interest'], and in the interests of removing the risk of jurisdictional challenge generally, the Committee believes that any proposed regulation of the disclosure of equity derivatives should ideally be incorporated explicitly into Chapter 6C of the Corporations Act itself, or the Corporations Regulations, rather than relying on vague definitions as a basis for Panel guidance.

Such an approach would mirror the current position in the United Kingdom where rules mandating the disclosure of equity derivatives above the 1% level have recently been added to the City Code.

However, the Committee is conscious that amendments such as these should not be made at this time if to do so would delay the Bill.⁴⁰

3.47 FINSIA also supported further disclosure arrangement submitting:

38 Australian Institute of Company Directors, *Submission 1*, p. 2.

39 Mr Jeremy Kriewaldt and Mr Tony Hartnell, *Submission 2*, p. 20.

40 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, p. 6.

...we consider that the use of these arrangements may continue to thwart some important disclosure and consumer protection provisions such as the substantial holding provision in section 671B of the Corporations Act 2001.

Further amendments to section 671B, and similar provisions, are required to ensure that all relevant information is disclosed to the market. We recommend that the Government consider further amendments to ensure market transparency.⁴¹

3.48 Treasury told the committee that it is considering the issue separately:

To address [the issue of equity derivatives] would require extensive further consultation and perhaps significant adjustments to the *Corporations Act 2001*. This would delay the introduction of amendments to facilitate the Takeovers Panel carrying out the role for which it was designed.

Treasury is currently considering looking into the question of equity derivatives. It is, however, being treated as a separate issue. The current Bill has a narrower focus. Accordingly, it does not specifically deal with the issue of equity derivatives.⁴²

3.49 During the hearings Treasury officials indicated that this issue was not expected in the near future:

I can only say that sometime [in 2007] we should come to some preliminary conclusions... It will depend to an extent on what we find as we go and on other priorities.⁴³

Committee view

3.50 The committee agrees with submitters that provisions governing the disclosure of equity derivatives are needed to alleviate the uncertainties that currently exist in this area. The committee is of the view that the consideration of these complex issues should not delay the passage of the current bill. The committee notes the prolonged timeframe anticipated by Treasury to address this issue. The committee considers, given the likely impact of equity derivatives on future Panel deliberations, that the Treasury should give the issue higher priority.

Recommendation 2

3.51 The committee recommends that once the bill is passed by the Parliament the Government commence a consultation process with a view to amending Chapter 6C of the *Corporations Act 2001* to establish a robust framework for the disclosure of equity derivatives relating to corporate takeovers.

41 Financial Services Institute of Australasia, *Submission 5*, p. 3.

42 Department of the Treasury, *Submission 6*, p. 1.

43 Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury, *Committee Hansard*, 1 December 2006, p. 27.

3.52 In considering a possible framework the Government should take into account the views put forward by the Law Council:

If an express provision for the disclosure of economic interests is to be included in the Act, the [Law Council] suggests that this objective would best be achieved by:

- inserting an appropriate definition of 'derivative interest' (or similar concept) into section 9 of the Corporations Act, and
- including net 'long' derivative interests in the concept of 'substantial holding' to be disclosed under Chapter 6C.

The effect of these changes would be to mandate disclosure under Chapter 6C of the Act where a person's net long derivative holding (or the aggregate of their physical and net long derivative holdings) was 5% or more of a target.

The [Law Council] considers that 'hard-wiring' these requirements into the Corporations Act in an explicit manner is a preferable way to achieve the policy objective of disclosure of substantial interests under equity derivatives. A technical failure to comply with these requirements would be unlikely to constitute unacceptable circumstances except in the context of a control transaction.⁴⁴

Recommendation 3

3.53 Subject to the recommendations made in this report, the committee recommends that the Parliament pass the bill.



Senator Grant Chapman

Chairman

44 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 9*, pp 6–7.