Parliamentary Joint Committee on Corporations and Financial Services

Corporations Amendment (Takeovers) Bill 2006 [Exposure Draft]

February 2007

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Recommendations

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'.

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.

Recommendation 3

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

Chapter 1

Introduction

1.1 On 7 September 2006, the Treasurer, the Hon. Peter Costello MP, released an exposure draft of the Corporations Amendment (Takeovers) Bill 2006, along with an explanatory statement. Treasury sought written comments by 5 October 2006.

1.2 The bill proposes amendments to Chapter 6 of the *Corporations Act 2001*, which regulates corporate takeovers and the powers of the Takeovers Panel. According to the explanatory statement the bill is:

> designed to allow the Panel to continue to act:
>
> - in an informal, effective, efficient and expeditious manner;
> - as the primary forum for resolving disputes during takeover bid periods;
> - relying on the specialist expertise of its members;
>
> so that the outcome of any takeover bid can be resolved by the target shareholders on the basis of its commercial merits.[1]

1.3 In particular, the bill proposes to:

- amend the definition of 'substantial interest';
- allow the Panel to take account of likely future effects of circumstances;
- before the Panel makes an order, limit those able to make submissions to each person to whom a proposed order is directed; and
- set a time limit for the Panel to review the decision of an earlier Panel.[2]

1.4 The bill was prompted by the Federal Court's *Glencore* decisions which interpreted the limits of the jurisdiction of the panel as set out in the current legislation. Concerns were raised with the Government that as a result of *Glencore*, the Panel's powers and jurisdiction could be viewed in a way that is too narrowly formulated to enable the Panel to perform effectively the role envisaged for it by Parliament.

Conduct of the inquiry

1.5 At a private meeting on 11 October 2006, the Parliamentary Joint Committee on Corporations and Financial Services agreed to inquire into the Exposure Draft of the Corporations Amendment (Takeovers) Bill 2006. The committee agreed to a

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1 Department of the Treasury, *Corporations Amendment (Takeovers) Bill 2006 — Explanation*, September 2006, p. 1.

2 The Exposure Draft and explanatory statement can be found on the Department of the Treasury's website at www.treasury.gov.au.

closing date for submissions of 17 November 2006 to allow submitters to provide the committee with modified versions of the submissions made to Treasury. A list of submissions appears at Appendix 1.

1.6 The committee held one public hearing on this reference in Canberra on 1 December 2006. Witnesses who appeared before the committee are listed at Appendix 2. The Hansard transcript of the hearing is available at www.aph.gov.au/hansard.

1.7 To ensure the bill's passage through Parliament during the Autumn sittings, the Corporations Amendment (Takeovers) Bill 2007 was introduced in the House of Representatives on 14 February 2007. The committee notes that minor changes were made to the bill as a result of submissions made to Treasury and to this inquiry, especially with regard to the 'substantial interest' concept. These changes are discussed in Chapter 3.

1.8 The committee originally agreed to report by 1 March 2007. In order to facilitate the timely passage of the bill, the committee agreed to bring forward its reporting date to 23 February 2007.

1.9 The remainder of this report is divided into two chapters. Chapter 2 provides an overview of the Takeovers Panel, its origin, role and functions and a brief discussion on the *Glencore* decisions. Chapter 3 explores the provisions of the bill, discusses the issues raised by submitters, and makes several related recommendations.

Chapter 2

Background

2.1 This chapter firstly provides an overview of the Takeovers Panel, its origins, role and functions. It concludes with a brief discussion of the issues raised by the *Glencore* decisions.

The Takeovers Panel[1]

2.2 The Panel is the main forum for resolving disputes about a takeover bid until the bid period has ended. The Panel is a peer review body, with part time members appointed from the active members of Australia's takeovers and business communities.

2.3 The President of the Panel, Mr Simon McKeon, described to the committee the operations and composition of the Panel:

> ...in the seven years that we have been operating, our focus has been on providing a dispute resolution regime that is informal, expeditious and, most importantly, has the support of the market that we operate in. It is a peer review model. There are approximately 46 members of the Takeovers Panel, drawn from a wide variety of professions and businesses in this country and each appointed for the contribution that they can make to resolving takeover disputes in this country.[2]

2.4 At the public hearing, Treasury explained the takeovers arrangements prior to the commencement of the Panel:

> The panel's predecessor, the Corporations and Securities Panel, operated from 1991 to 1999 and made only four decisions during that time. Instead the courts were the primary focus for resolving takeover disputes, so parties to a takeover frequently engaged in tactical litigation to block bids. This caused delays and costs and prevented takeovers from occurring.[3]

2.5 Treasury explained that the Panel was modelled on the UK experience where takeover disputes:

> ...were resolved by a non-judicial specialist panel, which made prompt commercial decisions. This was seen as a very successful system. It

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1 Parts of this summary are edited extracts taken from the Takeovers Panel's website, *About the Panel*, www.takeovers.gov.au (accessed 7 February 2007).

2 Mr Simon McKeon, President, Takeovers Panel, *Committee Hansard*, 1 December 2006, p. 6.

3 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.

resolved disputes promptly and effectively and was copied in other common law jurisdictions.[4]

2.6 The Panel is established under section 171 of the *Australian Securities and Investments Commission Act 2001*. It is given various powers under Part 6.10 of the *Corporations Act 2001* (the Act). The Panel's primary power is to declare circumstances in relation to a takeover, or to the control of an Australian company, to be unacceptable. It has the power to make orders to protect the rights of persons (especially target company shareholders) during a takeover bid and to ensure that a takeover bid proceeds (as far as possible) in a way that it would have proceeded if the unacceptable circumstances had not occurred.

2.7 The policy principles that the Panel aims to advance are those set out in section 602 of the Act. They essentially include the four 'Eggleston Principles' and an additional principle that the acquisition of control of listed companies or listed managed investment schemes take place in an efficient, competitive and informed market.

2.8 Section 659AA of the Act describes the Panel as the 'main forum for resolving disputes' about takeover bids during the lifetime of those bids. Under section 659B, private parties to a takeover do not have the right to commence civil litigation, or seek injunctive relief from the courts in relation to a takeover, while the takeover is current. Disputes which were previously resolved in the civil jurisdiction of the courts will be resolved by the Panel. Like decisions made by other administrative bodies, Panel decisions are subject to judicial review by the courts.

2.9 The Panel also has various review powers. The Panel has the power to review certain decisions of the Australian Securities and Investments Commission (ASIC) to grant exemptions or modifications to takeovers parties from the application of various takeovers related provisions of the Act.[5] The Panel also has a function in reviewing its own, first instance, decisions.[6] In such circumstances the review Panel consists of a fresh group of Panel members. There can be only one review of an original decision. The Panel also has a review function if a matter is referred from the court.[7]

2.10 When a matter is referred, the Panel must consider whether it will commence proceedings. If it does, the substantive President of the Panel appoints three members

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4 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.

5 In certain circumstances section 655A allows ASIC to exempt a person from, or modify the application of, Chapter 6 provisions. Section 656A allows such decisions to be reviewed by the Panel. Similarly, section 656A allows the Panel to review decisions made by ASIC relating to its power to modify the substantial shareholding provisions under section 673 of the Act.

6 *Corporations Act 2001*, s. 657EA.

7 *Corporations Act 2001*, s. 657EB.

to be the 'sitting Panel'. If the substantive President is on any particular sitting Panel then he or she will be the sitting President. The substantive President and the selected Panel members must ensure that the selected Panel members do not have any material conflicts or biases.

2.11 The Panel is expressly required under the Australian Securities and Investments Commission Regulations 2001 to ensure that its proceedings are:

- as fair and reasonable;
- conducted with as little formality; and
- conducted in as timely a manner…[8]

2.12 The Panel has published Rules which govern its proceedings.[9] Evidence is gathered primarily in the form of written submissions although the sitting Panel may convene a conference. The Panel has significant powers at a conference, including the powers to take evidence on oath, subpoena witnesses, examine witnesses or subpoena documents.

2.13 Although the Panel is required to formally publish few documents it considers that the market and investors will be best served if its decisions and policies, and the reasons for its decisions, are published. The Panel publishes on its website:

- the text of any unacceptable circumstances declarations, and consequential orders, and decisions as well as the reasons for those decisions;
- any guiding policies and procedures; and
- any rules designed to clarify or supplement Chapter 6 of the Act or which govern Panel proceedings.[10]

The *Glencore* decisions

2.14 The rationale for seeking amendments to the Act is two recent Federal Court decisions that considered the jurisdiction of the Takeovers Panel and the issue of equity derivatives.[11]

2.15 The facts surrounding the *Glencore* cases involved the takeover bid of Austral Coal (Austral) by the Centennial Coal Company (Centennial) in early 2005. At that time Glencore International AG (Glencore) had a 4.99 per cent stake in

8 Australian Securities and Investments Commission Regulations 2001, reg. 13.

9 These are made with respect to section 195 of the *Australian Securities and Investments Commission Act 2001*.

10 *Corporations Act 2001*, s. 658C and *Australian Securities and Investments Commission Act 2001*, s. 195, respectively.

11 *Glencore International AG v Takeovers Panel* [2005] FCA 1290 and *Glencore International AG v Takeovers Panel* [2006] FCA 274.

Austral. Glencore entered into 'cash settled equity swap' arrangements with two investment banks.[12] Under such arrangements the investor does not acquire any direct interest in any shares. The banks then bought shares in Austral (around seven per cent in total) to hedge their risk under the swap arrangements. Approximately two weeks after the combined holding had crossed the five per cent disclosure threshold Glencore announced to the ASX its holding and the existence of the swap arrangements.

2.16 In mid-2005, Centennial made an application to the Panel for a declaration of unacceptable circumstances in relation to Glencore's non-disclosure of its holding of Austral shares and the equity swaps. The non-disclosure was considered unacceptable by the Panel. This view was confirmed by a Review Panel, subsequently rejected by the Federal Court in the first *Glencore* case and later reconsidered for a third time by the Panel.

2.17 This time the Panel found that there was an 'effect' on the acquisition of a 'substantial interest' in the company.[13] The Panel considered that the swap arrangements, while they fell short of conferring a 'relevant interest',[14] nevertheless gave Glencore sufficient control over the relevant shares so that all the shares held by Glencore and the investments banks together constituted a 'substantial interest'. The Panel considered that Glencore had been able to benefit from this non-disclosure by acquiring shares for lower prices than if the true position had been disclosed. It ordered Glencore to make a payment of approximately 6.7 cents per share to Austral shareholders who had sold on market during the period of non-disclosure.

2.18 Glencore again contested the Panel's decision in the Federal Court. The court found that the Panel had erred in its decision that the non-disclosure of the cash settled equity swaps by Glencore was unacceptable.

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12 A cash settled equity swap is an agreement whereby the investor (in this case Glencore) does not initially acquire an interest in any shares but essentially allows the investor to purchase the shares shortly after the swap is settled. It operates as an arrangement between an investor and a bank whereby the bank (for a fee) agrees to pay the investor an amount equal to the difference between the value of a given number of shares at the time of the closing out of the swap, and the value of those shares at the time when the arrangement was entered into. Under such an arrangement the investor does not acquire any interest in any shares. In order to hedge its risk under such an arrangement, a bank might buy the relevant shares. The agreement allows the swap to be settled which creates an incentive for the bank to minimise its exposure and divest its share holding. The investor would know this and be in an ideal position to acquire the shares at a price likely to be lower than the market price. Mr Lucas, Vice-Chairman, Financial Services Institute of Australasia, gave the committee a 'real-life' example of cash settled equity swaps, *Committee Hansard*, 1 December 2006, pp 19–20.

13 *Corporations Act 2001*, ss. 657A(2).

14 Section 608 sets out what a relevant interest in securities is. It states the basic rule of 'holding, or controlling voting or disposal of, securities'.

Relevant interest versus substantial interest

2.19 The court decided that Glencore did not have a 'substantial interest', as required by subparagraph 657A(2)(a)(ii). In the court's view that expression requires a person to have an interest 'that can be a relevant interest or a positive power or right in relation to voting shares'.[15] The court said it would be a 'very curious result' if a person could be regarded as having a 'substantial interest' where neither the person nor any of their associates had any 'relevant interest' in any shares of the company. The court said that the scheme of the legislation was focused on regulating the acquisition of shares by reference to concepts of 'relevant interests' and 'voting power' and that the 'substantial interest' concept did not go broader than that.

2.20 The Law Council described two critical consequences of the interpretation of 'substantial interest' arising from the *Glencore* cases:

- first, that the Panel's jurisdiction to make declarations of unacceptable circumstances relating to the acquisition of a 'substantial interest' in a company or listed scheme is more limited than had been generally believed before this finding; and
- second, and of the greatest immediate policy concern, that the Panel now lacks the jurisdiction to regulate the disclosure of equity derivatives at the 5% level.[16]

The 'effect' test

2.21 Section 657A(2)(a) currently states that, before it makes a declaration of unacceptable circumstances, the Panel must have regard to the 'effect' of those circumstances on the control of the company. The court was critical of the Panel's conclusion that the non-disclosure had had an 'effect' on Centennial's bid.[17] The Panel concluded that the non-disclosure affected Centennial's bid by making it successful sooner, to a greater extent and possibly at a lower price. However, the court found that the Panel had not explained these conclusions by reference to evidence before it. While the court accepted that, of necessity, the Panel must engage in some speculation, the Panel did not explain adequately how its conclusions about the effects of the non-disclosure were based, either on findings or inferences of fact.

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15 *Glencore International AG v Takeovers Panel* [2006] FCA 274 at para 85.

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

17 As required by paragraph 657A(2)(a) of the *Corporations Act 2001*.

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

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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

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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]

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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.

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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, S*upplementary 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:

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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.

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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

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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]

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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]

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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:

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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.

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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.

Appendix 1

Submissions received by the Committee

1. Australian Institute of Company Directors
2. Mr Jeremy Kriewaldt and Mr Tony Hartnell
3. Chartered Secretaries Australia
4. Alan J Shaw Consulting
5. Financial Services Institute of Australia
6. The Treasury
7. Takeovers Panel

7a. Takeovers Panel

8. Australian Securities & Investment Commission
9. Corporations Committee, Business Law Section, Law Council of Australia

Appendix 2

Hearings and Witnesses

Friday 1 December 2006 - Canberra

Alan J Shaw Consulting
Mr Alan J Shaw, Consultant

Takeovers Panel
Mr Bruce Dyer, Counsel
Mr Simon McKeon, President
Mr Nigel Morris, Director

Financial Services Institute of Australia
Mr Mark Andrew Ley, Senior Manager
Mr Alastair Lucas, Deputy Chairman, Markets Policy Group

The Treasury
Ms Marian Kljakovic, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group
Ms Ruth Viner Smith, Manager, Investor Protection Unit, Corporations and Financial Services Division, Markets Group