Law Council
OF AUSTRALIA

The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
P O Box 6011
Canberra ACT 2600

Dear Mr Sullivan,

Inquiry into the Exposure Draft of the Corporations Amendment (Takeovers) Bill 2006

Thank you for your letter of 17 October 2006 inviting the Law Council to make a written submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the Exposure Draft of the Corporations Amendment (Takeovers) Bill 2006.

I have pleasure in enclosing a submission which has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia. Please note that the submission has been endorsed by the Business Law Section. Owing to time constrains, it has not been considered by the Council of the Law Council of Australia.

I apologise for not meeting your deadline of 17 November 2006.

Yours sincerely,

Peter Webb
Secretary-General

24 November 2006

Enc.

GPO Box 1989, Canberra,
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

Submission of the Corporations Committee of the Business Law Section of the Law Council in relation to the draft Corporations Amendment (Takeovers) Bill 2006

1 Introduction

These are the submissions of the Corporations Committee of the Business Law Section of the Law Council of Australia (**"the Committee"**) in relation to the draft Corporations Amendment (Takeovers) Bill 2006 (**"Bill"**). These submissions are provided in response to the invitation from the Federal Treasury on 7 September 2006. Please note that these submissions have been endorsed by the Business Law Section. Owing to time constraints, the submissions have not been reviewed by the Council of the Law Council of Australia.

The Committee supports the position that the Panel should have a broad-based jurisdiction, within constitutional limits, in order to discharge its functions without constant concerns about jurisdictional challenges. The Committee also supports the disclosure of substantial economic interests in companies and listed schemes, where those interests are held under equity derivatives.

The following submissions are directed at ensuring that the Bill achieves those objectives. The Committee is concerned that some aspects of the Bill require amendment in order to do so, and in particular to resolve the specific issues identified by the Federal Court in the Glencore cases.

2 Overview

In summary, the Committee believes that:

- the broadening of the Panel's jurisdiction can be achieved under the proposed new section 657A(2)(b) with the minor changes described below; and
- the proposed new definition of "substantial interest" is not necessary.

The Committee has the following concerns:

(a) **New s657A(2)(b) - catch-all declaration power**

The new powers in the proposed new section 657A(2)(b) should be more firmly linked to established policy and public interest requirements to avoid new jurisdictional issues.

The Explanatory Memorandum should also state explicitly, for the avoidance of doubt, that this new power is intended to give the Panel

jurisdiction to consider circumstances relating to economic interests under derivatives, whether or not they constitute a substantial interest.

(b) **Definition of "substantial interest"**

The proposed new definition of "substantial interest" should be deleted because it:

- is vague, creating new issues about the Takeover Panel's jurisdiction;
- would cause uncertainty about the application of Chapter 6, especially in circumstances that are currently exempt;
- does not clearly provide the Panel with jurisdiction to address issues relating to disclosure of equity derivatives; and
- is unnecessary to address the jurisdictional issues that it appears to be designed to rectify, if the proposed new s657A(2)(b) is enacted.

(c) **Disclosure of equity derivative positions**

The Committee also believes that it would be desirable to include new provisions in the Corporations Act mandating an explicit disclosure regime for equity derivatives under Chapter 6C. 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.

3 Definition of "substantial interest" does not provide clarity

The term "substantial interest" is not presently defined in the Corporations Act. The Bill proposes the following definition:

"*An interest in a company, listed body or listed managed investment scheme may be a substantial interest in the company, body or scheme even if it is not constituted by one or more of the following:*

(a) a relevant interest in securities in the company, body or scheme;

(b) a legal or equitable interest in securities in the company body or scheme; or

(c) *a power or right in relation to the company, body or scheme, or securities in the company, body or scheme.*"

The term "substantial interest" is the key concept in one limb of the Panel's jurisdiction.[1] The catalyst for the changes proposed in the Bill was a finding by Emmet J of the Federal Court in *Glencore International AG v Takeovers Panel*[2] that the holder of an equity derivative does have an "interest" in the

1 Section 657A(2)(a)(ii) of the Corporations Act.

2 [2006] FCA 274.

securities held by the counterparty to hedge its exposure under the derivative so as to cause that instrument to give rise to a "substantial interest" for the purposes of Chapter 6.

It followed from this finding that the Panel made an error of law in concluding otherwise and, because this error went to the Panel's jurisdiction, the Panel's declaration and orders against Glencore were quashed.

There are two critical consequences of this finding:

- 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.

As stated in the introduction to these submissions, the Committee supports the position that (a) the Panel should have a broad-based jurisdiction in order to discharge its functions without constant concerns about jurisdictional limits and challenges, and (b) substantial economic interests in companies and listed schemes should be disclosed.

However, the Committee does not believe that the inclusion of the new definition in the vague form proposed will necessarily achieve either of those objectives. Further, even if the definition were to be drafted so that it did achieve those objectives, the inclusion of the definition would have other undesirable consequences which would make it an unsuitable means of achieving the objectives.

The reasons for these conclusions, and alternatives to better achieve these objectives, are explained below.

Vagueness and uncertainty creates new jurisdictional issues

Legislative provisions which confer administrative powers in wide and ill-defined terms may be struck down as they allow a tribunal to define the limits of its own jurisdiction. While the High Court is likely to read down definitions and powers so that the powers of the Panel do not exceed its constitutional limits, this is difficult to do when, as with the proposed definition of "substantial interest", the term is only defined in the negative. It is not readily apparent how to read limits into a definition which is not intended to impose limits.

The present position is clear: the jurisdiction of the Panel in relation to the acquisition of a substantial interest is grounded in concepts of "interest" already defined in Chapter 6. Those concepts relate to the control, directly or indirectly, of rights in securities. The new 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 is clearly inappropriate.

A crucial link in Emmett J's reasoning in *Glencore* was his view that the concept of "substantial interest" must interpreted by reference to the terms used around it - in particular, the term "relevant interest": something which did not amount to a relevant interest (or some other positive power or right in relation to voting shares) could not be a substantial interest.[3] The proposed definition, therefore, makes this line of reasoning impossible.

There would arguably be no basis for the court to read the definition down by reference to any relevant limits, whether or not the limits established in Glencore, because the definition is deliberately unlimited. If the jurisdiction of the Panel is expressed or defined in terms which are unlimited, it will be open to further challenge.

While the Committee does not necessarily subscribe to the view that the changes proposed in the Bill are bound to lead to jurisdictional issues of this type, it considers that there is an undesirable risk that such a challenge could be mounted. Those issues could be avoided if no new definition was proposed.

Uncertainty about the application of Chapter 6

Chapter 6 presently contains a significant number of exclusions and exemptions from the concept of "relevant interest" and thus from the prohibitions on acquisitions in s606. The inclusion of the proposed definition of "substantial interest" would create significant uncertainty as to whether acquisitions which are expressly excluded from the scope of "relevant interests" are nevertheless subject to the jurisdiction of the Panel because they amount to the acquisition of a "substantial interest".

For example, why, if the Panel asserts that the new definition gives it jurisdiction to require the disclosure of economic interests under equity derivatives which are not "relevant interests", would the Panel not also be encouraged to assert jurisdiction to require the disclosure of the interests in securities of brokers, bare trustees, and banks holding security? Further still, why would the Panel not be encouraged to assert jurisdiction to regulate the acquisition of economic interests and "exempt" interests, even if fully disclosed?

These issues go far beyond the jurisdictional matters that arose in *Glencore*, and were intended to be rectified by the Exposure Draft. As there does not appear to be any policy requirement to address them, they should be avoided by removing the proposed new definition.

Not clearly applicable to equity derivatives

Critically, it is not clear that the proposed definition of "substantial interest", broad as it is, actually covers the interest held by the holder of an equity derivative.

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

[3] Paragraph 85.

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.

As observed by Emmett J in *Glencore*, something must first be found to constitute an "interest" before it can be a "substantial interest".[4] Resorting to the Macquarie Dictionary, Emmett J observed that an "interest" would usually indicate a "proprietorial notion".[5] That is consistent with the approach the Courts have historically taken to disputes concerning interests in real and personal property.

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 Committee 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% of 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.

Not necessary to rectify the jurisdictional issue in Glencore

If the proposed new section 657A(2)(b) is enacted, in a robust form, there does not appear to be any need to also endeavour to broaden the jurisdiction of the Panel in such a risky manner as the inclusion of the proposed definition of "substantial interest".

The new s657A(2)(b) would, if effective, give the Panel jurisdiction to deal with circumstances, including the disclosure of economic interests under equity derivatives, if they are unacceptable by reference to the policy objectives set out in s602, whether or not those circumstances concern the acquisition of a "substantial interest" in the narrow sense, or a contravention of the Act.

Therefore, it would be preferable to avoid the risks identified above, and achieve the objectives of the Bill in a much more straightforward way, by removing the proposed definition of 'substantial interest" and simply relying on the proposed new s657A(2)(b), modified slightly to ensure that the new power is firmly grounded in explicit policy considerations.

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4 Paragraph 80 and following.

5 Paragraph 81. By reference to the purposes of Chapter 6, Emmett was able to extend this concept to interests which are constituted only by *control over voting or disposal of shares*.

4 Proposed solutions

4.1 Clarifying jurisdictional limits

The Committee considers that the following changes would ensure that the Bill deals adequately with the jurisdictional issues that arose in the *Glencore* decisions, without the uncertainty inherent in the Exposure Draft:

(a) *Remove the new definition of "substantial interest".*

(b) *In the new section 657A(2)(b):*

(i) *Delete "whether".*

(ii) *Replace "having regard to" with "because they are inconsistent with or contrary to".*

The Explanatory Memorandum should also state explicitly, for the avoidance of doubt, that this new power is intended to give the Panel jurisdiction to consider circumstances relating to economic interests under derivatives, whether or not they constitute a substantial interest.

4.2 Disclosure of equity derivatives

The Committee assumes that the Exposure Draft Bill is intended to give the Panel power to require the disclosure of economic interests under equity derivatives that exceed 5% of a company's securities, alone or in combination with relevant interests in the company's securities.

In light of the uncertainties highlighted in section 3 above, 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.

If an express provision for the disclosure of economic interests is to be included in the Act, the Committee 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 Committee 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.