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(Subcommittee)

Reference: Exposure draft of the Corporations Amendment (Takeovers) Bill 2006

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JOINT STATUTORY COMMITTEE ON

CORPORATIONS AND FINANCIAL SERVICES

Friday, 1 December 2006

Members: Senator Chapman *(Chair)*, Ms Burke *(Deputy Chair)*, Senators Brandis, Murray, Sherry and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Mr McArthur

Members in attendance: Senators Chapman, Murray and Sherry

Terms of reference for the inquiry:

Exposure draft of the Corporations Amendment (Takeovers) Bill 2006

WITNESSES

Subcommittee met at 9.08 am

CHAIRMAN (Senator Chapman)—I declare open this public hearing of the Joint Committee on Corporations and Financial Services. The committee has agreed to meet today as a subcommittee for the purpose of this hearing because it is meeting while the Senate is sitting and some members of the committee are engaged with the legislation being debated in the chamber. On 11 October 2006 the committee resolved to inquire into the Corporations Amendment (Takeovers) Bill 2006. The bill amends the provisions of chapter 6 in the Corporations Act 2001 that relate to takeovers and the powers of the Takeovers Panel. It is designed to ensure that the panel continues 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.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. This gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudice to themselves. Any act that disadvantages a witness as a result of evidence given to a committee may be treated by the Senate as a contempt. It is also a contempt to give false and misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may of course be made at any other time during the hearing.

The Senate has resolved that an officer of a department of the Commonwealth should not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[9.10 am]

SHAW, Mr Alan J, Consultant, Alan J Shaw Consulting

Evidence was taken via teleconference—

CHAIRMAN—I welcome any observers to this public hearing and I now welcome our first witness, Mr Alan Shaw, who is joining us today by teleconference. The committee has before us your submission, which we have numbered four. Are there any changes or additions that you wish to make to the written submission?

Mr Shaw—No.

CHAIRMAN—Therefore, I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Shaw—Firstly, thank you for the invitation to address the committee and for your agreement to my doing so by teleconference. My position is that I agree with the broader policy objective in that the Takeovers Panel should deal with all matters relating to takeovers. The jurisdictional challenge that came out of the legal challenge may undermine that, and of course the preparedness to hear the case perhaps opens doors to courts potentially in future matters, but that is a separate issue. I also agree with the narrow policy objective—that is, to extend the jurisdiction of the Takeovers Panel to derivatives that are used in takeover matters. It is really the pathway to achieving those objectives that is in some difficulty.

In summary, my position is this: firstly, the amendments are not well drafted. They may raise further uncertainty and that could lead to challenge and therefore the broad objective will be lost. Secondly, as a matter of principle, the drafting should be clear and concise. A current government objective, as I am sure you are aware, and as is given by way of example in the Pearce consultation paper, is to reduce compliance burden on entities. That is not achieved if the drafting is confusing. Thirdly, it is unhelpful, in my view, to state what a thing is not without stating what it is. It does meet the purpose in terms of the definition that is proposed of negativing the Glencore decision perhaps, but the opportunity to advance a clearly articulated and logical structure for takeover law is lost. Of course, there are risks of challenges as noted in some of the other submissions.

Even if the amendments were better drafted, they may have some curious results. In my view, primarily the definition should not be proceeded with. If need be, there should be an amendment to the definition of ‘relevant interest’, or if it is easier to capture disclosure of derivatives, then by an amendment to chapter 6C; otherwise, though, I support the amendments, although as I said I would like to see them cleaned up of their oddities.

I conclude, though, by saying that the benefits, in my view, exceed the disadvantages. Therefore, I have expressed my position on the definition as a reservation, because I would not want to lose the valuable amendments while a rethink occurred. It would be better to proceed, if there was going to be a long delay, and then revisit the whole question. In fact, I note that would

also meet one of the points that Atanaskovic Hartnell raised in their submission, which is that a review should be undertaken. In summary that is my position, and that is all I have to say by way of opening.

CHAIRMAN—In relation to the difficulties created by the Glencore decision, obviously you do not believe that the proposed amendments completely resolve those difficulties. Would you care to enlarge on your views as to why that is the case?

Mr Shaw—Most of the amendments do address various difficulties. What concerns me is the risk that they introduce other uncertainties or give rise to other potential challenges. It was quite clear from the Glencore decision that the judge was warning that, if you had a third concept, which is what the Takeovers Panel referred to as 'substantial interest', you potentially introduce a whole lot of unintended consequences because the bricks that build the foundations for the takeover code are relevant interest. If you suddenly have a different concept from relevant interest, called a substantial interest, it is not at all clear where that will end up taking you.

CHAIRMAN—Can you enlarge on how your alternative definition of 'substantial interest' varies from that in the bill?

Mr Shaw—I would not try to define 'substantial interest'. It seemed to me that the term 'substantial interest' was really a contraction of 'substantial relevant interest', the reference to 'substantial' being of course contextual. In other words, it might be a large holding when there are other large lots; it might be a quite small holding when there is an evenly balanced control situation. It is substantial if two parties have 49 per cent each, for example, and someone holds the remaining two per cent. That two per cent can become a substantial relevant interest. But if there are lots of individual holders of five per cent each, then a holding of two per cent may not be substantial. That is what I felt the legislature was trying to achieve by using that adjective.

CHAIRMAN—I am looking at the appendix to your submission with the amendments. You are not proposing any change to that definition, as I read it.

Mr Shaw—No, I am not. In fact, that appendix is not an attempt to rewrite it; it was simply an attempt to set it out clearly, as much for my own purpose as for a reader of my submission, to see what it is that Treasury is proposing—not my proposal.

CHAIRMAN—So your proposals are really appendix 2, are they—in a drafting related context?

Mr Shaw—Appendix 2 is what I submitted to Treasury the first time around. My submission to this committee is an expansion of what I put in appendix 2.

CHAIRMAN—Do you believe that the Glencore decision limits the jurisdiction of the Takeovers Panel to the extent that it is no longer the main forum for resolving takeover disputes, in contrast to section 659AA, which makes clear that an object of the 2000 CLERP reforms was to make the panel the main forum for resolving disputes?

Mr Shaw—I do not think the decision necessarily does that, in the sense that I do not take the decision to have precluded the possibility that, in a situation similar to the Glencore one, a

relevant interest could not be found in connection with the swaps. The panel in the Glencore case took the view that there was no relevant interest and it seemed to me that, without further argument, the court accepted that position and worked forward from there without revisiting whether in fact there was a relevant interest. Therefore, I think it is possible in a future case to distinguish Glencore on that basis and for another court to say, 'We find that in fact there was a relevant interest created by these swaps', and therefore the difficulty that Glencore raises in terms of substantial interest just would not arise.

However, there is one other aspect of the Glencore matter, which I touched on in my introduction but did not expand on, that might undermine the panel—that is, if it is possible to challenge in the High Court and be referred to the Federal Court and then there is a finding of jurisdictional error because of an administrative error, you are really opening the door and reducing the effectiveness of the privative clause.

CHAIRMAN—In the section where you deal with 657A(2)(a), you indicate that you support the amendment but that these provisions should be simplified. Could you enlarge on the nature of that simplification?

Mr Shaw—I find that they are rather wordy and they do some odd things. For example, if you reduce 657A(2)(a), you get the effect that something has to appear to the panel so that the panel is satisfied. That seems rather curious. Also, there is a distinction drawn, as I point out in the body of my submission, in 657A(2) in paragraph (c). It refers to two concepts—likely to constitute a contravention and likely to give rise to a contravention. I find that a very difficult distinction. Of course, the difficulty also is that, in using different words like that, courts will struggle to give them different meanings, and I do not know what those different meanings might be.

CHAIRMAN—Do you have a suggested alternative wording?

Mr Shaw—No, I have not written one.

CHAIRMAN—You also refer to 657D(2)(a) as providing no guidance as to what might constitute other rights or interests that the panel might protect. Can you enlarge on the concern that you have regarding the broad fashion in which other rights or interests are expressed in this context?

Mr Shaw—My concern was that, having found that particular right is affected you can then look to protect other rights without any reference back to the first rights that have been affected. It would be possible to effect, for example, voting rights where there is not a voting issue. That is not articulated very clearly.

CHAIRMAN—You also say that you are concerned about the transitional arrangements impacting on proceedings that have been initiated prior to the commencement of this legislation but which have not yet finalised by the panel and that that might cause an injustice. Do you have a proposal to simplify that provision for transition purposes?

Mr Shaw—I do not have one, but what I think should happen is that, once the amendments take effect, for any matters arising thereafter, that definition should apply. This is because people might now take the view that, if you have a swap, that is not a substantial interest.

Senator SHERRY—You said earlier that you had not developed any alternative wording and you were critical of the wordiness of 657A(2). It is easy to say something should be simpler but actually sitting down and constructing it or reconstructing it is not easy. Have you expressed your concerns to the Treasury unit and made any suggestions as to how it could be simplified?

Mr Shaw—No.

Senator SHERRY—Would you care to have a go?

Mr Shaw—I do not mind having a go.

Senator SHERRY—I am sure Treasury officials are confronted frequently with claims that things should be simplified. I am always sympathetic to simplification, but even I struggle at times to come up with the wording to simplify it. It would be helpful for us all if you were able to make a positive contribution to simplification. I think you should do so if you can.

Mr Shaw—I am happy to offer a suggestion.

Senator SHERRY—I am sure Treasury officers will be watching the proceedings, so hopefully there can be a positive outcome.

CHAIRMAN—If there are no further questions, I thank you, Mr Shaw, for your appearance before the committee this morning. You have been very helpful in terms of our deliberations on the legislation.

[9.25 am]

DYER, Mr Bruce, Counsel, Takeovers Panel

McKEON, Mr Simon, President, Takeovers Panel

MORRIS, Mr Nigel, Director, Takeovers Panel

CHAIRMAN—Welcome. The committee has before it your submission, which we have numbered 7. Are there any changes or additions that you wish to make to the written submission?

Mr McKeon—No.

CHAIRMAN—I now invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

Mr McKeon—We will be brief in our opening statement. We are aware that a number of submissions have been made. We understand that the Takeovers Panel, having been in operation now for almost seven years, might not be the most high-profile authority that the Commonwealth government has; nevertheless, it has now been around for a little while. The points that we would like to make in opening are that, 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.

By and large we have enjoyed substantial support from the relevant takeovers community in the years that we have been in operation, and that support was formally vindicated in a report that we commissioned over the last 12 months or so. It was independently conducted. This review led to the interviewing of a sizeable number of business and professional figures in this country, who had in many cases nothing to do with the panel itself as far as membership goes. It quite objectively gave us a view as to how we were operating. Whilst we are presently working through a number of constructive suggestions that were made, overwhelmingly we received either a highly favourable or very favourable view from the marketplace. It is against that backdrop that we come here this morning.

The two Justice Emmett decisions in the Glencore litigation some time ago provided a surprising outcome to many. The outcome interpreted the way in which we go about the business of resolving takeover disputes in an unusually narrow way. I would like to make that point, because this morning we are here to encourage the parliament not to make any radical changes to the dispute resolution that was adopted six or seven years ago but simply to restore it to the regime the market understood was the parliament's original intention. It was simply, we would say, some surprising interpretations by or definitive statements from His Honour Justice Emmett that led us to wonder whether in fact what parliament originally had in mind was not now being

borne out by this one judge in the Federal Court. It is against that backdrop that the amendments have been proposed. The Takeovers Panel itself is broadly in support of each and every one of those amendments. We are aware that there have been some submissions made with some other suggestions.

In relation to the proposal by one or two that the parliament take the opportunity to introduce further measures to make it plain that equity derivatives should also be the subject of a very discrete disclosure regime, we would say that is not necessary at this point—and, in any event, we would have expected that to entail its own process, which might take quite some time. The reality from our perspective is that the decision made by the three panels in the Glencore case requiring disclosure of these equity derivatives, which was ultimately overturned by the Federal Court, was nevertheless a sound decision. It was a decision widely embraced by the market and a decision that was adopted by others in large high-profile takeovers, such as the bid by BHP Billiton for WMC. It is a relatively uncontroversial position that the panel took.

We would be quite hopeful that, if the amendments were put into effect by the parliament, we would be able to go about making the decision to require these derivatives to be disclosed in a relatively straightforward manner. So we are not pressing this committee at all to be actively considering disclosure of equity derivatives. That is all we have to say.

CHAIRMAN—Mr Alan Shaw has just given evidence to the committee. He raised some concerns about drafting aspects of the legislation. Have you had a chance to examine his submission and the issues that he raises?

Mr McKeon—Yes, between the three of us we have.

CHAIRMAN—Would you care to comment on his view that the proposed definition of 'substantial interest' is not very helpful and in fact may have unintended consequences?

Mr McKeon—I might kick off and then pass to either of my colleagues for a more technical conclusion. The definition of 'substantial interest' has not been a definition for 25 years. What I am saying is that the term has been used in the Corporations Law or act for almost three decades now. The takeovers community has come to understand why that was the case, and indeed in a number of decisions the term has been referred to and the courts themselves, even before the takeovers panel had primary responsibility for resolving takeover disputes, came to accept that there appeared to be a reason why that term was not properly defined.

A major reason for that is simply that it was felt that it was necessary to ensure that, when one is attempting to resolve disputes in takeovers, there is a certain breadth of ability for the relevant decision-making body—in our case, the Takeovers Panel—so as not to get bogged down in black-letter law. 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'. For 25 years the law has operated quite happily with the term just mentioned but not defined, and the proposed amendment now is simply one that says we should not confine the term to anything too narrow. There are other ways of going about that, but I might ask either the counsel or the director to respond.

Mr Morris—We should declare our interests. We employ Alan Shaw on a regular basis and we will employ Alan again. He is a very good lawyer and he has sat in as panel counsel from time to time. The definition really is a non-definition. Prior to the Glencore decisions there was no definition of 'substantial interest'. Parliament had a good number of opportunities to put in a definition. The term had been looked at a number of times, indeed by Emmett himself in the Fairfax case, and courts had not struggled with the lack of a definition for 25 years. We think the definition that has been put in is simply to say, 'This is primarily an anti-avoidance term. Don't go trammelling it with black-letter law definitions.'

No, 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.

Mr Dyer—Prior to the Glencore decision there was quite a bit of case law interpreting the term 'substantial interest', as Mr Morris has mentioned. Our view is generally that case law is quite helpful and has worked quite well. The aim of this non-definition, in effect, is to leave that case law in place so that it is still there for the benefit of practitioners in the market.

CHAIRMAN—Mr Shaw also raised the issue of the drafting of section 657A(2)(a), saying that it is too complex and needs simplification. Do you have a view on that submission from him?

Mr McKeon—I do not believe that we have a strong view. We can live with the words as they have been drafted.

CHAIRMAN—What about the issue that he raises about the potential for injustice because of the timing from which the amendments apply? He has argued that proceedings initiated prior to the commencement of the amendment but not yet finalised by the panel could result in an injustice.

Mr Dyer—I do not think we have a strong view on the transitional timing. Because we see this as, in effect, restoring the panel to where the market thought it was, we did not think there was such a great concern with that.

CHAIRMAN—I understand that, recently, you told *Inside Business* that the Glencore decision 'hasn't involved a radical change in what we do, but we have been very mindful of what the Emmett decision was'. Given the inherent potential for unintended consequences and undesirable uncertainty when you do legislate, does this not throw into doubt whether legislative change is necessary to allow the panel to operate effectively?

Mr McKeon—Both decisions forced us to stop and take a raincheck. Every decision that we make is potentially reviewable by a court. The regime introduced has the important objective of being expeditious, informal, et cetera. If our decisions are constantly reviewed by courts then clearly the whole regime will break down as far as the government's objectives are concerned. When I said on *Inside Business* that we had not radically changed our way of going about

business, that was absolutely right. But there is no doubt that, following the Glencore decision, our panels are spending more time carefully working through some of the implications that, I say again, we found surprising from His Honour's reasoning.

What we are saying very firmly this morning is that the amending legislation, which we hope will be passed in some form through parliament, makes it very clear that parliament is sending a strong message to the takeovers industry that its original intent for this informal commercially based expeditious process is precisely what it continues to want. Accordingly, to the extent that at the edges or possibly even more seriously over time a court were to say, 'No, we would rather take this back into a more literal black-letter definition, a more formal process oriented decision-making regime,' then we would have significant reservations. Currently, we are taking longer to make decisions. There are certain circumstances that would worry me enormously—for example, if we are required to have regard to the actual effect of circumstances. At the end of the day, much of what we do probably is not affected by the Glencore decision, but there is still a significant slice of what we might be asked to decide upon in the future that could be quite hamstrung.

Mr Morris—We hope that we have not bumped up against a case where the Glencore decisions do stop us making a declaration of unacceptable circumstances, when the panel really does think that things are unacceptable. In a good number of the more contentious matters since Glencore and now, the various solicitors acting for parties have run Glencore type arguments at us and have, in essence, threatened litigation. We think that the uncertainty that the Glencore cases have created both for us and the market is real. It does not help our ability to give quick and commercial decisions to have that sort of uncertainty.

Currently, someone is taking one of the panel's decisions to litigation, and the precise issues about likely effect that we talk about in the legislation are being argued. While we do not think that we have had a crash with Glencore decisions so far, there are very definite sounds and signs that people are looking to use them. Tactical delay and tactical litigation is, for many people, what takeover defences and takeover strategies are all about. Unfortunately, we feel there is an increased risk of tactical litigation because of the Glencore decisions, and these amendments are intended to say that tactical litigation is not appropriate.

CHAIRMAN—Mr John Elliott from Clayton Utz has suggested in a recent newsletter that as a result of the recent Federal Court decision in the case of Australian Pipeline Trust v Alinta, where Alinta challenged the panel's divestiture order in relation to units in Australian Pipeline Trust, some of the proposed amendments to the panel's power are no longer necessary. What is your view on that argument?

Mr Morris—We will tell you in February, because the decision is the subject of a Full Bench appeal this coming Friday. The judges are still well and truly out on that.

Mr Dyer—That is not my view. I think the decision has helped in some respects, but it has not gone as far as the relevant changes in the draft legislation.

Mr McKeon—It is important to note that the judge in APT v Alinta was the same judge—His Honour Justice Emmett—in the two earlier decisions. It is simply not going to be the case that he will overturn what he originally said. The fact is that the uncertainty remains. Upon reflection, I

think His Honour has considered the status and objectives of the panel and has slightly helped our case relative to where he was earlier, but I would emphasise 'slightly'.

Mr Morris—The question of 'substantial interest' was not raised in the APT v Alinta matter at all.

CHAIRMAN—The Treasurer claimed that the amending legislation is necessary to confirm the panel's role as the principal adjudicator in takeovers and also to minimise tactical litigation and free up court resources to attend to other priorities. However, has it not been the case that, since 2000, tactical court litigation has been replaced by tactical panel litigation, with the number of panel applications soaring to more than 30 cases a year?

Mr McKeon—For some years now we have had extraordinarily healthy activity in the takeovers market, involving literally hundreds of companies changing hands. The record of the panel is quite extraordinary. The stakes are often high. It is terribly easy to go to the panel to have a cause ventilated, and we think that is a good thing. But it is also a good thing that the panel sometimes receives an application and dismisses it within hours. It is also a good thing when there is a very genuine issue to be determined for that issue to be determined sometimes in a matter of days, and rarely more than 10 to 14 days. Sometimes we get what we describe inside the panel as 'serial applicants'—ones that seem to have complaint after complaint. We have no choice other than to receive those applications and to assess them on their merits. It may well be that in a given year—as has been the case, where we had more than 30 applications—a very sizeable proportion may have been referable to one takeover.

At the end of the day, we have a binary decision: do we continue with the panel process, which I think has extraordinary support from the market, or do we revert to a court based decision-making process? In my opinion, and in the opinion of literally dozens involved in this industry, it would be a very retrograde step to revert to a courts process. The panel is the best system that we have come up with in this country. It continues to be the best and most appropriate system for this particular area of dispute. In the scheme of things it remains very time effective, very cost effective and precisely what the community has wanted.

Mr Dyer—Most practitioners would think that there is a significant difference between the tactical litigation that occurred before 2000 and the use of the panel. That difference is in part that the proceedings in the panel do not tend to result in delay that impacts on the outcome of a bid or delay that prevents shareholders deciding the outcome of a bid. Previously, often the tactical litigation did have that effect: there was often an interlocutory injunction that stopped the bid in some cases altogether. There is also a difference in quality between the earlier period and the current period.

Senator SHERRY—Just going back to the point you made drawing a comparison between the level of takeover activity in the economy generally versus the level of panel activity, correlation is not necessarily causation, but I suspect you are right. Do you have any evidence or analysis on the takeover level in the community versus panel activity?

Mr McKeon—No. In a sense, such analysis would be relatively trite because of the size of the sample. The number of cases that we are dealing with every year is literally, at most, a few dozen. Bear in mind that it is often forgotten that our jurisdiction is way beyond listed

companies. We have had disputes that involve cooperatives and other forms of organisation as well. The numbers of organisations or companies changing control each year really do run into the hundreds. I think what we need and what every country craves is not a process that denies someone the right to complain when best practice has not been adopted in a takeover.

It is very important that we have a very easy-to-use tribunal, which we are. It costs nothing to come before us. You do not need to retain barristers. You can come and appear before us yourself or write if you need to. We are set up without the need to follow strict laws of evidence. It could not be made easier for someone to complain about the conduct of a takeover. It is against that backdrop that we say, 'When a complaint comes, we will deal with it efficiently, effectively and in an appropriately informal way.' We are getting the best of both worlds.

CHAIRMAN—Should we be trying to eliminate the ability of companies to use the courts to settle disputes in takeovers? Should the parties be allowed to choose between going to court, for example, for breaches of the law and going to the panel in relation to unacceptable circumstances?

Mr McKeon—That is simply not possible in this country. We have a federal Constitution. We are established by the federal government. As a layperson, I am actually glad that tribunals such as ours are ultimately accountable to courts. However, over the years—and I would have to say that this was another, from my perspective, surprising outcome of the Glencore litigation—the hurdles have been set relatively high when specialist tribunals are put in place, and government expects the members of those specialist tribunals to use their expertise to make good decisions. As you would expect, there is a line of authority both here and overseas that suggests that, if such a matter goes on appeal to a court, a court should set a relatively high hurdle before it becomes interested in such a matter. Again Emmett considered that and nevertheless said, 'No, I'm going to have a good look at what happened here.' To answer your question, firstly, it is not possible—but, in any event, I am quite relaxed that we remain accountable not only to parliament but also to the courts.

Mr Morris—The problem is that it is so easy if you have good lawyers to manufacture a contravention or at least an allegation of a contravention. If you have the two routes, people who want quick decisions will come to the panel every time and people who want tactical delay will go to courts every time, and that is likely to defeat the purpose. There is a route to the court currently, and that is through ASIC. ASIC is one of the agencies that is always empowered to take litigation to courts about takeovers. That is a sensible regime. Once you open up the route for contraventions, there are lots of clever lawyers who will find a suggestion of a contravention very easily when they want to take the tactical delaying litigation.

Mr McKeon—I would like to make one other point. In the lead-up to the establishment of the panel in March 2000 there was lots of comment about the fact that we would face court challenges early and frequently. One of the remarkable things was that it took five years before that occurred. But having said all of that, it is an ever-present issue and, when each and every sitting panel confers to deliberate on a decision, hanging over its head is the sceptre of potentially being reviewed by a court literally the next week. The sitting panels are not only very mindful of that—in more than 150 decisions now, they have essentially given very little scope to parties to appeal, because they do their job very well and are ably assisted by the panel's executive on either side of me. But every now and then it is possible that one of our decisions

can be reviewed. The purpose of the amending legislation is again to sensibly restore the panel to a position where it does not needlessly worry so much about the fact that parties may have too easy a route to get to the courts.

Senator SHERRY—You may not be familiar with this, but the circumstances that you are outlining remarkably parallel the experiences of the Superannuation Complaints Tribunal and its development or genesis, the difficulties—certainly in the first couple years—and question marks around power. To that extent I appreciate the difficulties. I was a little concerned with your earlier remarks. They were suitably tactful and diplomatic for you, but they did seem to me to indicate a level of frustration and surprise about the decision by Mr Justice Emmett. I appreciate why you are suitably diplomatic and tactful in your expressions. In reality it is very difficult to get over surprise decisions and interpretations from a justice, and we could be back here again in another couple of years perhaps having to deal with similar amendments as a result of a similar surprise decision.

Mr McKeon—There are no guarantees, and that might be right. However, we would say that this is a system that is worth investing in. If every now and then we have to come back to Canberra and say, 'Could you please help us?' because we have the overwhelming support of the market asking for that as well, then we would say that is time worth investing. If you want me to say that I feel like a sore loser then, yes, I will acknowledge that.

Senator SHERRY—I was not going that far—frustrated, perhaps.

Mr McKeon—At the end of the day, there was no appeal from ASIC for that decision beyond the second one, and it was felt best to simply say, 'Can we talk with our parliamentary superiors to get the amending legislation through?'

Mr Morris—The thing that we do need to make very clear is that it has been the policy of governments of all colours for 30 years that administrative decisions should ultimately be reviewable by courts. That is not going to change and we are not looking to change that. Panel decisions ought to be ultimately reviewable by the courts and, if the panel gets things seriously wrong, then the courts should tell us, and we have absolutely no fear about that.

The proposed legislation is going to send a fairly strong signal that the parliament thinks this system is worth proceeding with and that parliament wants to keep takeovers as much as possible out of courts. The proposed legislation is a good message from parliament to the courts to say, 'Please support this body and take some sensible decisions with it.'

CHAIRMAN—Thank you for those responses. The Australian Institute of Company Directors has raised several issues in relation to the legislation. One of those is that it is concerned about the language of the new proposed section 657A(2)(b) and that it will give rise to undesirable uncertainty about the panel's jurisdiction. The second concern, with the same proposed section, is that it could be vulnerable to constitutional challenge on the basis that it is an attempt to give the panel power to define its own jurisdiction. Concern has been expressed about 657A(2), which I referred to earlier and which proposes to enable the panel to take action to prevent likely future effects in circumstances brought before it. In submissions to us it has been argued that Justice Emmett's decision did not and does not prevent the panel from using its expertise to make a decision on the likely future effects. In fact, he ruled that the panel had not

on the particular occasion involving the Glencore decision identified the real effects of unacceptable circumstances, and that in fact the panel erred in its decision making. Can you respond to those concerns about those particular amending clauses?

Mr McKeon—The panel is often going to be asked to give a view as to what the market would have done if something had turned out differently. Let me give you the Glencore example. More than 13 per cent of the shares of a company that was being bid for by another company were acquired in the market with the knowledge and arguably under the instruction of Glencore. Normally, as soon as the acquisitions had reached five per cent, Glencore would have been required to tell the market that it had bought that parcel and, as it continued to buy more, would be required to continue to apprise the market of what it was doing, but it kept silent. What the panel has to do in those circumstances is consider what the market reaction would have been if it had actually been informed of those acquisitions. That is why we have the takeovers panel. The three successive sitting panels, comprising in aggregate a group of company directors, professional investment bankers, lawyers and various others, use their collective wisdom to try to work out what the market would have done in what were inevitably hypothetical circumstances. Glencore denied the panel the ability to understand what would have happened. That is why we have the panel; so that people with expertise, without regard to the actual evidence, which in many cases will simply not be available, can take a view.

As to constitutionality and defining our own jurisdiction, it is very important that one always bear in mind that we have to operate not just according to a handful of amendments here but the entire chapter 6. Section 602 very clearly states what the policy behind the chapter is and what our job and role is. It is dangerous to suggest that, just because we are looking at a particular amendment here and a particular amendment there, all of a sudden we can basically poke our nose into anything. That is not the case at all. We can only go where the chapter allows us to go. It is very clear that it starts with having an interest in the change of control of the corporate entity.

Mr Morris—In terms of the concerns raised by the institute, we have talked to you about the definition of 'substantial interest' and why we think it is not a good idea to define it accurately. We think it is a good idea to leave it as a broad anti-avoidance provision. The courts have dealt with it happily for 25 years and they have not found the uncertainty that the institute was concerned about.

In terms of constitutionality, Mr Dyer will be able to talk about that a little. Constitutionality of the panel and transgressing constitutional powers has been an issue from the outset of the panel. Parliamentary Counsel and Treasury have been looking at it. It has been an issue that people have thought about every step of the way. It was looked at in 1991 in the Precision Data case, where the High Court came down in the panel's and the government's favour. In terms of the current legislation, if you walk through it, there are a number of pointers there where the Office of Parliamentary Counsel has clearly thought about constitutional issues and the need to frame the wording of the legislation fairly carefully to make sure that we do not infringe on constitutional powers. If the Office of Parliamentary Counsel is happy with the wording and does not think that there is a constitutional issue, that is a pretty good indication. The words in this draft bill are those of Parliamentary Counsel. We are pretty sure that they have been thinking about the constitutionality issue.

Mr Dyer—The first point to make is that parliament confers many powers that are much broader than this. 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. It is important to bear that in mind. 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. If you do that it encourages people to look for loopholes and to draft around the definition. That is the first comment, in relation to the breadth of the power.

In terms of constitutional validity, the suggestion was that the power might be vulnerable to constitutional challenge because it seeks to give the panel the power to define its own jurisdiction. That appears to be picking up on some dicta in one particular High Court case dealing with migration, the case of Plaintiff S157. There was a passing comment, I think directed at a comment by counsel in that case, which was suggesting that parliament might confer very broad powers on a minister to decide within the bounds of what the parliament itself can deal with in respect of the power in relation to aliens, and that there could be a very broad conferral of discretion on a minister to decide which aliens should be able to enter into the country, stay and so forth. It was a piece of dicta in that context, which we do not feel is relevant to this particular legislation. We do not have any serious concerns.

Mr Morris—We are perfectly happy to have the sorts of concerns that the institute has raised taken back to the Office of Parliamentary Counsel for OPC to have a look at. We will be guided by OPC.

CHAIRMAN—You have expressed a view this morning that the amendments essentially restore the panel's position to what the market generally understood it to be before the Glencore case. There has been some media commentary to the effect that the proposed amendments dramatically increase the panel's powers and the scope of the activities that it could undertake. What is your response to those claims?

Mr McKeon—I do not agree. The market has expected us to have a suite of powers that would enable us to come in as requested from time to time to resolve disputes, as I have said two or three times this morning, expeditiously, informally and so on. When we look at the particular amendments that are being proposed, firstly, we have our non-definition of 'substantial interest'; we would argue strongly for no change to almost three decades of takeovers legislation. We are broadening the ability to have regard for the likely effect, and what we would be saying is that, frankly, that is what the market has been expecting us to do now for some years.

We have not mentioned this morning the issue of orders, but clearly it is silly for anyone to expect the panel to interview 300,000 shareholders if there is a big bid and ask each and every one, 'What would you like to see out of this?' Basically, the amendment there, I think sensibly, confers upon the panel the expectation that we will deal with the interests of parties who have a material interest that has been dealt with deleteriously, and on behalf of target shareholders there is the target board. We would argue strongly that this is about restoration. Frankly, if there is any technical widening of the powers here, we would say that the market itself would not be

unhappy at all with such a technical widening. But we would still be saying that we are not convinced that there is such a widening.

CHAIRMAN—Professor Ian Ramsay has made the comment in relation to the legislation that panel decisions need to be able to keep pace with changes in the takeover market, such as the use of equity derivatives. Do you believe that these amendments will eventually be overtaken by market instruments and, if so, how do you prevent that happening? How can legislation anticipate all of the tools and tactics that corporate raiders might use in future takeover bids?

Mr Morris—We need to declare our interest again. Professor Ramsay is a member of the Takeovers Panel. Part of not trammelling 'substantial interest' is just to say that we do not know what is coming down the track—nobody does. People did not see private equity coming down the track as a major player. We think that we need to keep the legislation tied to fairly simple principles. Section 602 goes back to the efficient, competitive informed market and the Eggleston principles. They are the principles based regulation that is, in essence, going to future-proof the Takeovers Panel and future-proof the government's takeovers legislation. It is keeping those principles and saying that this is all about making sure that the basic principles are upheld and that the panel can operate on the basis of those principles, rather than looking at specific types of instruments and transaction. We agree with Professor Ramsay that the provisions in these proposed amendments are going to help future-proof the Takeovers Panel and the government's takeovers legislation.

Mr McKeon—There are many who fall into the trap of thinking that the big change that occurred in the year 2000 was the replacing of judges with businesspeople. That was one change and a good change for this particular industry, but the bigger change was replacing black-letter law with what we have now, a principles based system. As Mr Morris has just said, the beauty of a principles based system is that we will always be one step behind the creative and inventive professional. But the regime that we have today enables us to catch up instantaneously as a decision is made and say whether we feel uncomfortable about a trend that is emerging or a particular form of conduct. To use a tax analogy, chapter 6 is a giant part 4A of the tax act; it is peppered with anti-avoidance.

Going back to the question a while ago about tactical litigation, there are very few practitioners nowadays that spend a whole lot of time thinking, 'How can I be sneaky and get through this legislation?', because basically no matter how hard they work they will simply be met with the same response from the panel: 'We think that your sneaky work has ended up with something contrary to some very simple principles, and unless you can explain why it isn't sneaky, that is the end of it.'

Senator SHERRY—I have a final question related to the issue of equity derivatives. I keep an eye on inventiveness with respect to financial instruments, which seem to be continuously emerging and morphing. Are there any other financial instruments that have come to your attention recently that could lead to a concern?

Mr McKeon—I would like to answer that question this way. In a free and open economy we ought to have choice.

Senator SHERRY—Informed choice.

Mr McKeon—That is quite right. Thank you for correcting me. The panel, comprised of the members that it has, is very supportive of, as you say, informed choice for market participants. I am quite sure that we have not seen the last development in this area. It is one thing to have a share in a company, but you can also have an option, a futures contract, a contract for difference and so the list will go on. It is all about information, which is one of those important sacrosanct principles that we now have to operate under.

It is terribly important that target shareholders, in particular, know who has some control over ultimately the shareholding capital through whatever interesting device may have been dreamt up in some back room. To answer your question, no, I do not think that we are seeing any particular development at this time that makes us uncomfortable where we would ask, 'How will we deal with that?' But it is another thing to say that the market for contracts for difference, or equity derivatives, is continuing to explode in its sophistication, and basically it is just reacting to its own market, which is looking for more choice.

Senator SHERRY—I have not looked at figures, but I believe that the increasing level of activity is generated from overseas. Is that causing any practical difficulties for the Takeover Panel?

Mr McKeon—The answer to that is, no, and I will come back to a particular response in just a moment. In relation to the statement of where the activity is coming from, do not sell our own market short.

Senator SHERRY—No, I am not. I just think that there is an increasing level from overseas.

Mr McKeon—That is probably right. I do not have the facts at my fingertips. The local institutions, the local sophisticated investor, in my experience outside of the panel, is just as-up-to-date as many of the major players around the world. To get to the nub of your point, are we at risk of being duped by international market forces because of a sophistication that we are not used to? No, I do not believe so.

Senator SHERRY—Not so much duped. Does it lead to a range of practical difficulties for you that are harder to deal with and analyse?

Mr McKeon—No. Occasionally we have been involved in disputes that have had an extraterritorial aspect to them, and so far we have had little difficulty in cooperating with other regulators. For the record, some years ago the Australian Takeovers Panel convened the first ever international conference of takeovers regulators in this country. That is a conference that now keeps going. We were not able to collaborate with our regulatory colleagues in other places some years ago and it is much easier now. Obviously that helps to some extent to keep on top of the issue that you are talking about. No, my tummy is not telling me at this point that we have any particular concerns that we cannot address.

Mr Morris—In practical terms, foreign bids add a few days on to every one of our decisions. An example is the current dispute in relation to the takeover bid for Rinker. Cemex is the bidder. All of these big bidders have sophisticated Australian lawyers so that takes out most of the offshore issue and offshore risk. They operate through Australian solicitors, so we do not have the sort of cross-jurisdictional problems that you might think about. But it is timing. We

normally give people two or three business days to get submissions back to us, but their solicitors might say, 'It's 5 o'clock tonight here, but they haven't got up in Barcelona and they haven't gone to bed in Monterey; we're going to need another 24 to 48 hours to prepare our submission.' That is one of the main things that we are seeing at the moment. ASIC is probably seeing some other things—growing internationalisation of takeovers and more Australian companies with foreign shareholders. We have not seen a lot of problems, but the Cemex bid for Rinker is one of the ones where ASIC had to do a reasonable amount of work to get a bid going that would also work for the US shareholders. They have some significant US shareholders in Rinker; it is very much an American-operation company. But so far we have not seen those problems. ASIC has had to do a bit of work with dual jurisdiction bids.

CHAIRMAN—Thank you, gentlemen, for your appearance before the committee this morning and your assistance with our deliberations on the legislation.

Proceedings suspended from 10.22 am to 10.46 am

LEY, Mr Mark Andrew, Senior Manager, Markets Policy, Financial Services Institute of Australasia

LUCAS, Mr Alastair, Vice-Chairman and Managing Director, Goldman Sachs JBWere

Evidence from Mr Lucas was taken via teleconference—

CHAIRMAN—I welcome the witnesses from the Financial Services Institute of Australasia. Would you like to comment on the capacity in which you appear?

Mr Lucas—I am appearing as deputy chairman of Finsia's markets policy group.

CHAIRMAN—The committee has before us your submission, which we have numbered 5. Are there any changes or additions that you wish to make to the written submission?

Mr Ley—No.

CHAIRMAN—Having confirmed that, I now invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Mr Ley—Finsia appreciates the opportunity to appear before this committee. Finsia was formed following the merger of the Securities Institute of Australia and the Australasian Institute of Banking and Finance. We are a leading provider of financial services education and professional development and the largest financial services professional body, representing over 20,000 members. Finsia is committed to maintaining and raising the standards and integrity of the financial services industry. Finsia's market policy group includes 15 experts specialising in mergers and acquisitions, many of whom are also members of the Takeovers Panel. We aim to reflect members' views on policy issues to government and regulators by initiating and commenting on reforms that will bring about more effective market practices. A recent example was the market policy group's proposals for takeovers law reforms that are currently being considered by Treasury.

An efficient and effective takeovers regime is an integral part of the operation of the equities market and the Australian economy. In our opinion, since the CLERP reforms the Takeovers Panel has been successful as an effective, efficient and expeditious forum for resolving disputes during takeover bids. We consider that the creation of the panel as the central dispute resolution forum ensures that the court process, sometimes involving considerable delays, is not used as a tactical device in the takeovers process. We have been concerned that the recent Federal Court decisions may be interpreted as limiting the jurisdiction and practical operation of the Takeovers Panel. This would have an adverse impact on Australia's takeovers regime. We consider that this bill contains measures to ensure that the panel can operate effectively and efficiently as the main forum for resolving disputes during a bid. Accordingly, it has our full support. We understand that other bodies have raised jurisdictional concerns about some of the drafting. We do not have a view on the merits of these concerns but support the underlying premise of the provisions contained within the bill.

Finsia notes that the Glencore legislation involved the panel's ability to make determinations concerning the impact of cash settled equity swaps. With the permission of this committee, as part of Finsia's opening address, may I pass over to the Deputy Chair of Finsia's Markets Policy Group, Alastair Lucas, to outline some of the practical consequences resulting from the increasing use of these swaps. Alastair is Vice Chairman of Goldman Sachs in Australia, a panel member and a senior fellow of Finsia.

Mr Lucas—Could I first apologise that I am not there in person. As you would appreciate, it was in fact very easy to get a flight in to Canberra today but impossible to get a flight out. Hence, I could not make it and I apologise.

I have a lot to do with takeovers. My primary role is to advise on takeovers as Chairman of Goldman Sachs investment banking group in Australia, and I have been involved in some of the significant takeovers in this country. I believe the issues that are being dealt with in this proposed change in legislation are very important. If I may be allowed, I will talk briefly about the real world of cash settled equity swaps and, if you like, the mischief that they can cause in the market. Would it be appropriate for me to take you through a real-life example of what can happen?

CHAIRMAN—That might be very helpful.

Mr Lucas—I will do this as a theoretical example, but you can assume that I am fairly confident that the practice I am about to outline can or has actually occurred. Imagine a situation where a corporation—let us call it corporation A—would like to get an interest in corporation B and it would like its activities not to be public initially. Corporation A could go along to its stockbroker or its investment bank and enter into a contract where it said: 'We really want to get an interest in company B, but we don't want it disclosed. We will enter into a contract with you, the investment bank, whereby for a fee we will take all of the economic upside on X number of shares in company B and all of the downside on X number of shares in company B. Whatever happens, we will look at the stock price of company B as it is today and, at some time in the future, we are going to say to you, the investment bank, that we are going to settle for the difference. That is to say, if the stock price has gone up, you are going to owe us money; and, if the stock price has gone down, we are going to owe you money.' That is all that contract is.

Especially in stocks that are not very deeply traded, what is the investment bank going to do, having entered into this contract for a fee? The only logical thing for it to do is to buy either physical shares or options—that is, the real underlying shares or options over the real underlying shares, such that it is not at risk. With some more deeply traded shares it might be possible for the investment bank to take other hedging strategies. For example, if it were over BHP shares, an investment bank might be able to get a reasonable proxy by buying, say, iron ore futures and coal futures. What I am saying is that the investment bank is not obliged to buy the requisite number of shares in company B. It could enter into any number of hedging strategies or indeed it might choose to take a risk. But the overwhelming likelihood is that the investment bank will just go out and buy B shares, because that is the most logical and easiest way for it to hedge its risk. Then we get to a later stage, and company A would really like to buy this holding. If it had been buying the holding in the market and had that been disclosed, because of its corporate interest it might have pushed up the price, so what it does is it contacts its investment bank and says, 'We want to cancel that contract and we want to settle.' That is within the terms of the

contract. The contract then is settled for cash one way or the other and, all of a sudden, the investment bank no longer has a need to hold the physical shares in company B. Indeed, it has now got a holding in company B that is at risk in that it is not hedged at all, and what it wants to do is sell those shares.

If company A is quick, it will go to its stockbroker, which may be the same stockbroking arm of the same firm, and it will place an order for that many shares, knowing that that many shares is very likely to be loose in the market and able to be acquired quickly. Sometimes those shares can change hands in a matter of minutes. What can happen during the course of the buying I have just described is that the situation now is that company A has a 15 per cent interest in company B, which it could have acquired very quickly in that time.

If company B had issued notices to find out who the owner was of the shares, the investment bank will have replied under sections 672A and 672B that it owns them as principal. The market will not have been aware that company A had an interest in company B and has effectively been building up the stake. I would argue that the mischief to the market there is that the purchases that company A made in company B might have been at a different price had the market known that company A indeed had an interest in company B. Cash settled swap transactions can happen in a number of ways, but that is an example of the kind of case that market participants would have witnessed and which this new legislation, in part, is designed to address.

CHAIRMAN—So what you are saying is that the new legislation would require disclosure of that strategy.

Mr Lucas—There are two points to make here. The new legislation will give the Takeovers Panel the power to say that that in fact constituted a substantial interest, if the facts support it in the particular case. The circumstances that I just went through could well have been a relevant interest. There could well have been conversations between company A and the stockbroker that led to what truly is a relevant interest. But in terms of the quick operation of the panel, generally it is not practical for it to have conferences and get oral statements from a lot of witnesses. Of course, people choose not to remember these conversations. These conversations are often very hard to bring into evidence.

What we can sometimes have is what has been in truth a relevant interest. It looks and smells like it has been a relevant interest, but if there is no opportunity for the panel to find a relevant interest, under the new definition of 'substantial interest' it will be possible, if the facts support it, for the panel to find the kind of conduct that I just described in fact constituted a substantial interest and enabled the panel to find that that activity was unacceptable circumstances. I would put it to the committee that that kind of behaviour is indeed very unacceptable circumstances.

Proceedings suspended from 11.00 am to 11.11 am

CHAIRMAN—We will resume with Mr Ley and Mr Lucas.

Senator SHERRY—When Mr Lucas finished his response to your question I called a halt.

CHAIRMAN—Thank you for that worthwhile example.

Mr Lucas—Mr Chairman, I was going to complete that story if that was helpful.

CHAIRMAN—Yes, that would be of assistance. Your view is that with the legislation the Takeovers Panel will be able to intervene to increase the transparency of that sort of transaction?

Mr Lucas—Yes. It goes beyond just transparency. What we have here is a situation where, with cash-settled swaps, if they are not to be regarded as relevant interests—and under current legislation the panel cannot apply the notion of substantial interest—we do have a situation where it is technically possible, in fact beyond technically possible, for someone to buy 20 per cent of a company and then control perhaps another 10 per cent of the company through cash-settled swaps. It is more than a transparency issue. They can have de facto control over a company using these kinds of contracts. It is hard to know how much this is going on in the market, but the current advice being given to corporations is that cash-settled swaps are good to go. I hesitate to use the words 'floodgates', but we could expect their use to increase rather than decrease if this legislation does not see the light of day.

CHAIRMAN—Mr John Elliott from Clayton Utz suggested in a recent newsletter that, as a result of the recent Federal Court decision in the Australian Pipeline Trust v Alinta where Alinta challenged the panel's divestiture order in relation to units in the Australian Pipeline Trust, some of the proposed amendments to the panel's power are no longer necessary. I understand from our earlier session with the Takeovers Panel that that decision is subject to appeal, but assuming the appeal does not succeed and the judgement stands would you agree that the amendments may not be necessary?

Mr Lucas—I will not claim detailed expertise here, but in the Alinta judgement it was in relation to whether the panel had the ability to judge the impact on the market. If John Elliott is correct, what I would say is that the proposed legislation causes no harm and gives only clarity. If the Alinta judgement means that clarity is not required, then so be it. I think the market would be better off having that clarity. Secondly, it goes to only one aspect of it. For example, the definition of 'substantial interest' is much needed. Notwithstanding Alinta, significant elements of this new legislation are required anyway. It would be my judgement that there is no need to amend this proposed legislation because of Alinta.

CHAIRMAN—The Australian Institute of Company Directors has raised a couple of issues in relation to proposed new paragraph 657A(2)(b), and again I raised these matters with the Takeovers Panel when they were before us a little while ago. I also seek your view on the AICD submission. They expressed concern that the language of the proposed new paragraph 657A(2)(b) will give rise to undesirable uncertainty about the panel's jurisdiction and also that it could be vulnerable to constitutional challenge on the basis that it is an attempt to give the panel the power to define its own jurisdiction. What is your response to those concerns of the company directors?

Mr Lucas—That is a technical legal issue in relation to how a court would view this new section. I doubt that Finsia would have a technical legal opinion on that.

Mr Ley—Finsia do not have any technical legal or constitutional expertise, but we recognise there is a bit of uncertainty in the marketplace about the panel's role and the circumstances that

the panel can take into account. Parliament clarifying how those provisions will work, in our opinion, would assist in resolving that uncertainty.

CHAIRMAN—There have also been submissions expressing concern about the bill's proposed definition of 'substantial interest' and expressing the view that in fact it is a non-definition. Again, the Takeovers Panel believed that this in fact was desirable because in effect it gives the flexibility that is needed for their role to be properly fulfilled. What is Finsia's view of that definitional issue that has been raised in submissions?

Mr Lucas—We would sympathise with the draftsman's task in defining 'substantial interest'. We think making it clear that a substantial interest can exist will enable the panel to find a substantial interest. In essence, Justice Emmett said that you cannot have a substantial interest unless it is a relevant interest. This definition enables the panel, as is necessary, to find the notion of substantial interest outside a relevant interest. As I said earlier, 'relevant interest' is a very technical term that requires evidence. It is a very specifically defined term. If the panel is going to be restricted to dealing just with relevant interests, then these kinds of issues that I have described cannot be dealt with. In my view, the definition proposed by making it very clear that a substantial interest outside of a relevant interest can exist should be effective.

CHAIRMAN—Mr Alan Shaw in his submission to us has raised the issue of the proposed amendments applying to proceedings which have been initiated prior to the commencement of the legislation but not yet been finalised by the panel. He put a view of the potential for injustice to arise from such arrangements. What is Finsia's view on that issue?

Mr Lucas—I have quite a practical view. People who enter into cash-settled swaps in these circumstances know full well the panel's view. They are being advised by lawyers who are fully aware of the technical nature of Emmett's decision and the reason why the panel failed, and they are fully aware that the panel had a draft guidance note which would have required disclosure of cash-settled swaps. They know that the guidance note has not been made effective. People who are entering into these transactions are not innocents who need protection. They are people going into it with full knowledge of the circumstances. They have the full knowledge that this legislation is going through parliament. I must say I have very little sympathy for that view.

CHAIRMAN—I have covered the issues that I wished to explore with you. On that note, I will thank both of you for your appearance before the committee and for your contribution to our inquiry on this legislation.

Mr Lucas—I do apologise for not being there in person.

CHAIRMAN—That is understood.

[11.21 am]

KLJAKOVIC, Ms Marian, Acting Manager, Market Integrity Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury

SMITH, Ms Ruth Viner, Manager, Investor Protection Unit, Corporations and Financial Services Division, Markets Group, Department of the Treasury

CHAIRMAN—The committee has before it your submission, which we have numbered 6. Are there any alterations or additions that you wish to make to the written submission?

Ms Kljakovic—No.

CHAIRMAN—I invite you to make a brief opening statement, at the conclusion of which I am sure we will have some questions.

Ms Kljakovic—We have commented on the detail of the bill in the written submission to the committee. I would like to explain briefly why the panel was designed the way that it has been, to give some context to the current law, what the role of the panel is and what the bill is doing. 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.

The design of the current panel was heavily influenced by the UK experience, which was a complete contrast. Takeover disputes in the UK were resolved by a non-judicial specialist panel, which made prompt commercial decisions. This was seen as a very successful system. It resolved disputes promptly and effectively and was copied in other common law jurisdictions. The panel was constituted in its present form to bring specialist market expertise to decisions, to give fast, informal and uniform decisions, to minimise tactical litigation and to free up court resources. The panel was intended to replace the courts as the principal forum for resolving takeover disputes. It was designed to act quickly and relatively informally and to take a commercial view of events rather than a legal one. It was intended to be a peer review body and not a court. Its role is not to decide if the law has been broken or to enforce the law or to determine what the parties' rights are but to determine what rights should be created.

The reforms were founded on a desire to move away from a court based system of dispute resolution. The panel is not a court; it is a peer review body. The panel's regulations say that the object of the regulations is to ensure proceedings are as fair and reasonable, conducted with as little formality and conducted in as timely a manner as possible. As to using experts, all the members of the panel have specialist knowledge of takeovers but they are not all lawyers. They are part-time members who act as panel members as and when called upon.

It was against that context that 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.

CHAIRMAN—Do you believe that market participants were given sufficient time to understand the significance of the changes proposed in the bill and make considered submissions to the Treasury, given that they were allowed only three months to provide their comments on the exposure draft? What made the legislation so urgent that a longer time for consideration could not have been allowed?

Ms Kljakovic—It was felt that there was a real risk that the operations of the panel might be compromised. Also, this is quite a specialist market. The people who are interested in the bill would be very familiar with the operations of the panel and probably able to react reasonably promptly.

CHAIRMAN—In January this year the *Australian* reported that an independent review has been ordered into the constitutionality of the Takeovers Panel. Can you explain to us the result of that review?

Ms Kljakovic—I do not think that I can. That might be a misunderstanding. I know the panel itself initiated a review of its functions and how it was perceived by the market, and it might be that that is what the article is referring to.

CHAIRMAN—Mr Simon McKeon, who appeared before the committee this morning as President of the Takeovers Panel, recently told *Inside Business* that 'every decision that a panel makes is ultimately, quite possibly, susceptible to a legal challenge'. How does the proposed bill provide greater legal certainty if every panel decision is ultimately challengeable?

Ms Kljakovic—As the panel chairman said earlier, it is entirely appropriate that every decision is open to review. If the panel exceeds its jurisdiction, the court does have the power to intervene. What the bill is trying to do is not in any way to limit the courts' power to intervene on those sorts of issues—the jurisdictional question. It is just trying to make sure that the panel has wide enough powers to do its job. For example, the panel can rely on the specialist expertise of its members to make some judgements about the likely effects of particular circumstances.

CHAIRMAN—I would like to ask Treasury's view of the proposition I referred to earlier witnesses. That is the proposition of Mr John Elliott of Clayton Utz, who has suggested that as a result of the recent Federal Court decision in the Australian Pipeline Trust v Alinta some of the proposed amendments are now unnecessary. As I said earlier, that decision is subject to appeal but, assuming the appeal is rejected, do you accept Mr Elliott's views. If not, why not?

Ms Kljakovic—No, I do not agree with that. The bill is still necessary. There was perhaps a slight shift in the approach of Mr Justice Emmett, but there was not a fundamental change. He did not say, 'No, I've changed my mind. A substantial interest is something different.' I do not think that Alinta basically reached a fundamentally different conclusion from Glencore in a way that would make the bill unnecessary.

CHAIRMAN—Mr Jeremy Kriewaldt, in his submission, is critical of the proposed bill. He describes it as an unfocused expansion of the panel's jurisdiction, equivalent to applying a patch which is much larger than the supposed hole. What is Treasury's response to that critique?

Ms Kljakovic—That would be a minority view. It is not shared by the majority of submitters or the market.

Senator SHERRY—When you say a 'majority', do you mean a clear majority?

Ms Kljakovic—A clear majority.

CHAIRMAN—The Law Council has expressed concerns, which your submission refers to, about the proposed definition of 'substantial interest' and that it may cover interests in the company that do not concern rights related to securities—for example, employees, customers and suppliers. In Treasury's submission it says that, if the section is capable of such an interpretation, the wording could be adjusted to preclude that interpretation. Why has that not been done in this legislation, so that that possible legal uncertainty is removed now by expressly precluding those particular interests, rather than leaving it to see what happens and perhaps having to involve further amendments later?

Ms Kljakovic—The policy intention is not to have the definition covering employees, customers and suppliers. This is a drafting issue. Our understanding is that 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.

CHAIRMAN—The Law Council also questions whether the proposed definition of 'substantial interest' will achieve the bill's policy objective. Firstly, can you explain the rationale for the proposed definition and, secondly, how it will in fact achieve the objective of the legislation?

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

CHAIRMAN—The Law Council has also recommended that the proposed definition of 'substantial interest' be removed and reliance simply be taken on the proposed new provision 657A(2)(b). In Treasury's view, what negative implications would this have on the objectives of the amending bill?

Ms Kljakovic—The problem with that is that, if you rely on the new provision, the new provision refers you back to section 602, which in turn uses the words 'substantial interest'. That would not get around the narrow interpretation of 'substantial interest' that was found in

Glencore. If we do not rewrite the definition of 'substantial interest' we are still stuck with the problem that it is more restrictive than it had traditionally been thought to be. Does that answer your question?

CHAIRMAN—Can you expand a little on that?

Ms Kljakovic—The argument from the Law Council was that the new section 657A(2)(b) meant that you would not need to rely on the use of the definition of 'substantial interest' in 657A(2)(a). Instead you could go straight to the principles under section 602 to found jurisdiction. But the problem is that when you go to 602, 602 also uses the words 'substantial interest' as well as 657. You are in a circularity. You are still constrained by what 'substantial interest' means.

CHAIRMAN—The Institute of Company Directors raises some concerns with regard to the language of proposed new paragraph 657A(2)(b): that it will give rise to undesirable uncertainty about the panel's jurisdiction; and that it could be vulnerable to constitutional challenge—again, we have raised these issues with earlier witnesses—on the basis that it is an attempt to give the panel the power to define its own jurisdiction. In your submission you indicated that you believe this is unlikely to be a significant risk. Can you explain why you believe that to be the case?

Ms Kljakovic—The policy intention was not to have that result. We did take advice from the Australian Government Solicitor, which was to the effect that that would not result. We are relying basically on that advice.

CHAIRMAN—You have received the advice that your submission indicated that you were seeking on the constitutionality?

Ms Kljakovic—We have.

CHAIRMAN—That advice was positive?

Ms Kljakovic—It was.

CHAIRMAN—In your submission you also indicate that you are considering the issue of equity derivatives as a separate matter to this proposed legislation. Can you give us some indication as to what form those considerations are taking, what stage they have reached, when they are likely to conclude and what the outcome might be?

Ms Kljakovic—I am afraid that would be a bit difficult. They are still at a preliminary stage. We do not have a policy on that yet.

Senator SHERRY—Are you examining other new forms of financial instruments, if I could use that as a description? There has been a constant evolution of financial instruments in this area in recent years.

Ms Kljakovic—There has been. We do try to monitor developments in private equity, leveraged buyouts and hedge funds. But as you say, it is constantly evolving. We do keep an eye on it.

Senator SHERRY—What do you mean by 'keep an eye on it'? Although not in the mainstream press, certainly in the financial specialist press, and at every financial services conference that I attend, there is constant reference to and, in some areas, statements of growing concern about some aspects of these financial instruments.

Ms Kljakovic—We would probably be reading the same articles.

Senator SHERRY—Attending the same conferences?

Ms Kljakovic—Yes, and downloading the same statistics as to the growth of particular instruments. If something does seem to give serious cause for concern, we would be advising on that.

Senator SHERRY—My assumption is that you do have constant liaison with APRA, ASIC and the Reserve Bank, because they are obviously at the coalface, so to speak, in respect of the issues presented by these instruments?

Ms Kljakovic—Yes, we do.

Senator SHERRY—What is your time frame for the examination in this particular area? Can you give us any indication in the case of equity derivatives?

Ms Kljakovic—I am afraid I cannot give you a very precise indication. I can only say that sometime next year we should come to some preliminary conclusions.

Senator SHERRY—That is pretty vague.

Ms Kljakovic—That is pretty vague. It will depend to an extent on what we find as we go and on other priorities.

CHAIRMAN—Can I ask for your view on Ian Ramsay's comment that, in relation to the proposed legislation, panel decisions need to be able to keep pace with changes in the takeover markets, such as the use of equity derivatives, and he has argued that these amendments will eventually be overtaken by market instruments. How can we keep up with the tools and tactics that corporate raiders are likely to use in future takeover bids in relation to the legislative process? Is it simply a matter of reacting or is there a way in which we can anticipate this?

Ms Kljakovic—One reason for the panel being designed the way it was is that it was an attempt to keep things flexible and relatively informal so that the panel could respond to changing circumstances, without prescribing too precisely that this instrument falls within or this instrument falls without. As you say, they are constantly evolving and the panel needs to constantly respond. The intention is to keep the legislation reasonably flexible and to let the panel get on with its job.

CHAIRMAN—The Law Council proposes the introduction of new provisions in the Corporations Act mandating an explicit disclosure regime for equity derivatives under chapter 6C. What is Treasury's view on that proposition?

Ms Kljakovic—That is part of our larger consideration of equity derivatives. That could turn out to be a relatively major change, which would need due consideration and consultation.

CHAIRMAN—The Australian Institute of Company Directors also expressed concern that the proposed rewording of paragraph 657D(1)(a) might unduly narrow the range of persons affected by a proposed order who would be entitled to an opportunity to make a submission to the panel. Do you have a response to that concern?

Ms Kljakovic—It is largely a question of practicality. If several hundred thousand people are affected, it is very hard to give them all an opportunity to be heard and most of them would not exercise that. The amendment is simply directed at the practicalities of the situation.

CHAIRMAN—Can you explain the relevance between the Glencore decision that prompted this legislative amendment and the proposed amendments to section 657D?

Ms Kljakovic—I will just remind myself. Is this the question about the rights or interests of any person or group of persons affected?

CHAIRMAN—Yes, it would be.

Ms Kljakovic—This was directed by a concern that perhaps one particular interest of a person might be affected but it might be more realistic to right the situation by adjusting another right. That was designed to give slightly more flexibility in the sorts of remedies that the panel would give to avoid the situation where you take a technical view and say only one particular interest was affected, and therefore that is the only one that we can alter, even though we would get back to the situation that we should have been in if we varied another interest.

CHAIRMAN—They are the issues that I wanted to explore with you.

Senator SHERRY—I have nothing further.

CHAIRMAN—If that is the case, I thank both of you for your appearance before the committee and for your help with our inquiry on the legislation.

Subcommittee adjourned at 11.43 am