AUSTRALIAN SECURITIES COMMISSION AND JOHN FAIRFAX HOLDINGS LTD

Corporations and Securities Panel.
Decision handed down 29 September 1997

BC Oslington QC and TD Castle (instructed by Australian Securities Commission) for the Australian Securities Commission.

TF Bathurst QC and TGR Parker (instructed by Blake Dawson Waldron) for BIL.

RBS Macfarlan and AJ Payne (instructed by Allen Allen & Hemsley) for the Merrill Lynch Companies.

A Rogers QC assisted the Panel.

Before: President Byrne, Deputy President Higgs, Mr Stanford. **D Byrne (President), W Higgs (Deputy President) and G Stanford (Member):**

1. Introduction

1.1 Glossary of Terms

Unless the context otherwise requires, the following terms shall have the meaning assigned as below:

(a) Application means an Application by the ASC in relation to Fairfax shares dated 15 August 1997 lodged with the Panel on 15 August 1997;
(b) ASC means Australian Securities Commission;
(c) ASC Law means Australian Securities Commission Law;
(d) ASC Regulations means Australian Securities Commission Regulations;
(e) ASX means Australian Stock Exchange Ltd;
(f) BIL means Brierley Investments Limited ARBN 002 982 407, a foreign company registered in New South Wales. It can also mean BIL, any of its subsidiaries or any of them collectively;
(g) BIL Purchases means Fairfax shares purchased by BIL on 17, 24 and 27 June 1997;
(h) Eggleston Principles means the principles set out in paragraph 4.2;
(i) Fairfax means John Fairfax Holdings Limited ACN 008 663 161;
(j) Federal Court Proceedings means the proceedings described in paragraph 1.6;
(k) Judgment means the judgement given by Emmett J on 5 September 1997 in the Federal Court Proceedings;
(l) Godine means Godine Capital Pty Ltd ACN 009 237 290;
(m) Harlesden means Harlesden Securities Pty Ltd ACN 009 218 151;
(n) Harlesden Contracts means five equity swap agreements entered into between MLAF and Harlesden on 27 March 1997;
(o) Law means the Corporations Law;
(p) Merrill Lynch means Merrill Lynch & Co. Inc., the ultimate holding company of the Merrill Lynch group, incorporated in the United States, or any of its subsidiaries or any of them collectively;
(q) MLAF means Merrill Lynch (Australia) Futures Ltd ACN 003 639 674;
(r) MLAE means MLAE Nominees Pty Ltd ACN 066 325 746;
(s) Panel means the Panel of sitting members constituted by Mr JH Pascoe, President of the Corporations and Securities Panel, on 22 August 1997 for the purpose of hearing this matter, pursuant to s 184(1) of the ASC Law and being:

- Denis Byrne (President)
- Warwick Higgs (Deputy President)
- Graham Stanford (Member);

(t) Parties means the collective description of the ASC, BIL and Merrill Lynch;
(u) Yellow Ridge means Yellow Ridge Nominees Pty Ltd ACN 076 764 826.

1.2 Application by the ASC

It having appeared to the ASC that the conduct of BIL and MLAF constituted or may have constituted unacceptable circumstances pursuant to sections 732(1)(a), (b) and / or (d) of the Law, the ASC lodged an application with the Panel on 15 August 1997, pursuant to section 733(1) of the Law. The ASC submitted that unacceptable circumstances had occurred in relation to the purchase of shares in Fairfax by subsidiaries of BIL on three days in June 1997, and also in relation to the conduct which culminated in those share purchases. In the Application, the ASC stated that:

(a) the share purchases in question (BIL Purchases) occurred on 17, 24 and 27 June 1997;
(b) on those days MLAF sold 22.7 million Fairfax shares, being approximately 3% of Fairfax's issued shares;
(c) on 17, 24 and 27 June 1997 BIL through its subsidiaries purchased 22.7 million Fairfax shares; and
(d) prior to those sales occurring, MLAE on behalf of MLAF held 4.99% of Fairfax's issued shares.

The Panel summarises the grounds set out in the Application as follows:

(a) the BIL Purchases were not purchases between arm's length parties acting independently;
(b) each of the equity swap transactions entered into between MLAF and Harlesden, a BIL subsidiary, on 27 March 1997 was structured to provide an incentive to MLAF to sell the Number of Shares on ASX on the Valuation Dates;
(c) each of the Harlesden Contracts was structured to provide incentive for BIL to purchase the Number of Shares made available for sale by MLAF on the Valuation Date; and
(d) the combined economic effect of the BIL purchases and the first three Harlesden contracts was to put BIL in the same position it would have been as if it had purchased 3% of the shares in Fairfax from Daily Telegraph Holdings BV for $3.00 per share on 27 March 1997.

1.3 Declaration/Orders Sought

The ASC sought a declaration under section 733(3) that unacceptable conduct occurred:

(a) in relation to the BIL Purchases; and / or
(b) as a result of conduct in relation to shares in, or the affairs of, Fairfax engaged in by BIL, Godine, Yellow Ridge, Harlesden, MLAF and MLAE.

Pursuant to section 733(3), the ASC alleged that it was in the public interest for the Panel to make the declarations because:

(a) if no declaration was made, the circumstances of and surrounding the BIL Purchases could easily be replicated by any other person wishing to avoid the economic consequences arising from the obligation to wait 6 months before acquiring a further 3% interest in the shares of a company under section 618 of the Law;
(b) it is necessary to prevent conduct of the type referred to in paragraphs 15 to 35 of the Application from occurring to enable the acquisition of shares in companies to take place in an efficient, competitive and informed market; and
(c) it is appropriate to provide redress to the shareholders of Fairfax in respect of the matters referred to in paragraphs 32 and 34 of the Application.

If the Panel made one or more of the declarations sought, the ASC invited the Panel to make orders under s 734(2) of the Law that:

(a) BIL and / or its subsidiaries dispose of 22.7 million Fairfax shares within 30 days of the making of the order to a person not associated with BIL and on such other terms as the Panel deems fit;
(b) upon a disposal of any of the shares in accordance with (a) above, BIL cause to be sent to the ASC, within 3 business days thereafter, all contract notes relating to the disposal or disposals;
(c) prior to disposal of the shares referred to in (a) above, BIL and / or it subsidiaries be prohibited from exercising any voting or other rights attached to the 22.7 million Fairfax shares which were the subject of the BIL Purchases; and
(d) such further or other order as the Panel deems fit.

1.4 Constitution of Panel

The Panel was constituted under a determination of Mr JH Pascoe, President of the Corporations and Securities Panel, on 22 August 1997. The sitting members who constituted the Panel for the purposes of hearing this matter were Mr Denis Byrne (President), Mr Warwick Higgs (Deputy President) and Mr Graham Stanford (Member).

1.5 Inquiry and Brief

Pursuant to regulation 20 of the ASC Regulations, the Panel decided on 22 August 1997 that it would hold an inquiry into the matters raised in the Application and notified all relevant parties of that decision. The Panel prepared a brief setting out a general description of the matters to be examined, a summary of the grounds presented in the Application and issues which the Panel required parties to address in their submissions. The Brief was dated and issued by the Panel on 22 August 1997.

1.6 Federal Court Proceedings

The BIL companies sought orders of review in the Federal Court in relation to:

(a) the decision by the ASC under section 733 of the Law and the processes by which the ASC made that decision to seek declarations of unacceptable circumstances;
(b) the decision of Mr JH Pascoe, President of the Corporations and Securities Panel, to appoint Messrs Higgs and Stanford to the Panel, notwithstanding disclosure by each of them to Mr Pascoe of interests which each of them had which could conflict with the proper performance of their functions in relation to the matter; and
(c) the decision of Messrs Byrne, Higgs and Stanford to hold an inquiry into the matter.

On 5 September 1997, Emmett J dismissed BIL's application and gave reasons in the Judgement.

1.7 History of the Application

The ASC lodged its Application with the Panel on 15 August 1997. Pursuant to section 733(4), the Panel was required to make its declaration within 30 days after the day on which the application was made or any other period as the Court ordered. As part of the Federal Court Proceedings, Emmett J ordered that the date for the making of the Panel's declaration be extended up to and including 29 September 1997.

The extension was sought by the Panel because of the need for the Federal Court to deal with the issues raised in the Federal Court Proceedings before the Panel could effectively commence its inquiry.

1.8 Submissions

The Panel called for expressions of interest from non-parties through advertisements placed in national newspapers on 29 August 1997. No expressions of interest were received. Written submissions were received from the ASC, BIL and Merrill Lynch, all dated 12 September 1997.

Written rebuttal submissions were received from the ASC, BIL and Merrill Lynch all dated 18 September 1997.

1.9 Conference

The Panel decided to hold a conference to enable the Parties to address the Panel and to allow the Parties to lead evidence and cross examine witnesses. The Parties were each represented by Senior Counsel. Because the Application and proceedings became very legalistic, the Panel considered it was necessary to engage Mr Andrew Rogers QC to assist the Panel.

BIL and Merrill Lynch objected to Mr Rogers' participation. The Panel draws attention to this because it is a clear indication of how the original legislative intention appears to have miscarried. The intention which underwrote the establishment of the Panel was to have a body of suitably qualified persons with wide commercial experience apply their knowledge and expertise, without being constrained by the laws of evidence, to determine within a short time frame whether what occurred was or was not unacceptable conduct. Instead, the Application of the ASC was subjected to a technical and legalistic examination. This statement is not a reflection on Counsel but rather the legal framework within which the Panel is required to operate.

In the first instance, the Panel held a preliminary conference with the Parties to reach agreement on the procedures for the conduct of the conference. The conference was held on all or part of four days (15, 19, 22 and 23 September 1997) (the Conference).

The Panel further decided that it was in the interests of an informed market that the conference should be open to the public. The Panel agreed with one of the parties that if any particular part of the conference should deal with confidential matters, the conference would be closed for that part of the matter.

2. Facts

The Parties agreed to most of the facts relating to the Application. Insofar as not agreed by one or other of the Parties, the Panel finds the following to be the relevant facts.

2.1 Fairfax is a public company incorporated in the Australian Capital Territory and is listed on ASX.

2.2 BIL is a foreign company registered in New South Wales. BIL is the ultimate holding company of:

(a) Godine;
(b) Harlesden;
(c) Blue Ridge Nominees Pty Limited ACN 076 569 983;
(d) Orange Ridge Nominees Pty Limited ACN 076 764 782;
(e) Yellow Ridge, and
(f) Bowpine Pty Limited ACN 003 984 576

2.3 Merrill Lynch & Co. Inc is incorporated in the United States and is the ultimate holding company of the Merrill Lynch Group. Companies within the Merrill Lynch Group operating in Australia include:

(a) MLAF; and
(b) MLAE.

2.4 Prior to 16 December 1996, Daily Telegraph Holdings BV (DTh), the ultimate holding company of which was Hollinger International Inc. (Hollinger), held 25% of Fairfax issued shares. Conrad Black was at that time the Chairman of Hollinger.

2.5 As at 16 December 1996, the other substantial shareholders in Fairfax were:

Bankers Trust	12.97%
Publishing & Broadcasting Limited	11.84%
Permanent Trustee	8.68%

2.6 As at 16 December 1996, there were eleven (11) Directors of Fairfax, of whom Conrad Black and Daniel Colson were also officers of Hollinger.

2.7 On 16 December 1996, Hollinger announced to ASX that DTH had agreed to sell its 25% shareholding in Fairfax to three Australian subsidiaries of BIL as follows:

(a) shares representing 19.9% were to be acquired unconditionally; and
(b) as to the remaining 4.99% (the Outstanding Parcel) BIL would seek approval to acquire that parcel from an extraordinary general meeting of Fairfax.

2.8 Merrill Lynch acted as adviser to DTH on the transaction between Hollinger, BIL and their respective subsidiaries.

2.9 On 16 December 1996 BIL acquired a relevant interest m about 19.98% of Fairfax issued shares as follows:

(a) Blue Ridge Nominees Pty Ltd acquired 91,007,624 shares at $2.80 per share pursuant to an agreement to which Telegraph Group Limited, DTH and BIL were parties; and
(b) Orange Ridge Nominees Pty Ltd acquired 60,552,978 at $2.85 per share pursuant to an agreement to which Telegraph Group Limited, DTH and BIL were parties.

Prior to that date, BIL held a relevant interest in 100 Fairfax shares acquired by Bowpine Pty Ltd in 1991.

2.10 By reason of section 615 of the Law, and the acquisitions referred to in paragraph 2.9, BIL was prohibited from acquiring any further Fairfax shares other than in accordance with one of the exceptions stated in Part 6.2 of the Law. In the absence of a takeover offer, two available options for BIL were:

(i) to obtain shareholder approval to acquire the Outstanding Parcel under section 623; and
(ii) to rely upon the creep provisions under section 618 to increase its entitlement to Fairfax shares by 3% after the expiry of every 6 months.

2.11 On 17, 18 and 21 December 1996 representatives of BIL were reported in the press as saying that BIL proposed to acquire further Fairfax shares in reliance upon section 618 of the Law if Fairfax shareholders did not approve the section 623 resolution.

2.12 On about 10 January 1997 Merrill Lynch acquired the Outstanding Parcel from Hollinger and / or its subsidiaries.

2.13 On 21 February 1997 an extraordinary general meeting of Fairfax:

(a) elected Rodney Price and Sir Roger Douglas (officers of BIL) as directors of Fairfax; and
(b) refused to pass a resolution which, pursuant to section 623 of the Law, would have permitted BIL, through it subsidiary Yellow Ridge, to acquire the Outstanding Parcel.

2.14 Between 22 and 25 February 1997, representatives of BIL were reported as saying that BIL proposed to acquire further Fairfax shares in reliance upon section 618 of the Law, that is to acquire up to 3% of Fairfax shares after the expiry of every six months after 16 December 1996.

2.15 On 27 March 1997, MLAF or alternatively MLAE on its behalf, acquired the Outstanding Parcel from another subsidiary of Merrill Lynch for an amount of approximately $3.00 per share, by way of an on market cross.

2.16 On 27 March 1997, MLAF and Harlesden, a BIL subsidiary, entered into five cash settled equity swap agreements (the Harlesden Contracts). There was no obligation in the Harlesden Contracts to sell or acquire or to refrain from selling or acquiring Fairfax shares.

Number of Shares	Valuation Date	Termination Date
7,500,000	17/06/97	24/06/97
8,5OO,000	24/06/97	01/07/97
6,751,905	27/06/97	04/07/97
7,000,000	18/12/97	29/12/97
8,092,099	23/01/98	02/02/98

The first three Harlesden Contracts relate to about 3% of the Fairfax shares, and the Valuation Date of the first and fourth Contracts were the dates upon which BIL was permitted to creep under section 618 having regard to the acquisition on 16 December 1996 referred to in paragraph 2.9.

2.17 Pursuant to terms of the Harlesden Contracts, MLAF was obliged to pay to Harlesden, if positive (or receive from Harlesden if negative), an amount calculated by using the following formula:

Amount payable = Number of Shares × [N1 + N2 + N3 - A$3.00]

where:

Number of Shares is the number set out for each contract in paragraph 2.16.

N1 = Volume weighted average trading price of Fairfax shares on the Valuation date, irrespective of the vendor.

N2 = Dividend per Fairfax share paid or payable before the Valuation Date.

N3 = (a) if MLAF sold the "Number of Shares" in the ordinary course of trading on ASX on the Valuation Date, the value weighted average trading price of those shares, sold by MLAF only, minus N1 or;
(b) otherwise "zero".

2.18 On 7 April MLAF:

(a) sold 22,751,905 Fairfax shares to Westpac for A$2.99 by a crossing on ASX; and
(b) entered into a swap agreement with Westpac with a valuation date of 6 June 1997 and a termination date of 13 June 1997, which provided for settlement by way of either cash payment or physical return of shares at MLAF's election.

2.19 On 6 June 1997 Westpac sold 22,751,905 Fairfax shares to MLAF on its behalf, for $3.30 by a crossing on ASX, upon the exercise by MLAF of its option under the swap agreement referred to in paragraph 2.18(b) above to take physical delivery of the shares to settle the swap.

2.20 In the week leading up to 17 June 1997, representatives of MLAF met to consider whether MLAF would or would not dispose of some or all of its Fairfax shares on 17, 24 and 27 June 1997 (being the Valuation Dates of the Harlesden Contracts).

2.21 On 17 June 1997, 11,105,874 Fairfax shares were traded on ASX. Of that:

(a) Yellow Ridge purchased on ASX 7,500,000 Fairfax shares; and
(b) MLAF and / or MLAE on its behalf, sold on ASX 7,331,716 Fairfax shares by releasing 89 parcels of Fairfax shares for sale.

2.22 5,015,988 of the Fairfax shares sold on ASX by or on behalf of MLAF on 17 June 1997 were purchased on ASX on behalf of BIL.

2.23 On 24 June 1997, 11,650,820 Fairfax shares were traded on ASX. Of that:

(a) Yellow Ridge purchased on ASX 8,500,000 Fairfax shares; and
(b) MLAF and / or MLAE on its behalf, sold on ASX 8,500,000 Fairfax shares by releasing 70 parcels of Fairfax shares for sale.

2.24 7,461,089 of the Fairfax shares sold on ASX by or on behalf of MLAF on 24 June 1997 were purchased on ASX on behalf of BIL.

2.25 On 26 June 1997 BIL lodged a substantial shareholder notice with ASX advising that BIL had increased its relevant interest in Fairfax from 19.98% to 22.09% by reason of the purchases by Yellow Ridge on 17 and 24 June 1997.

2.26 On 27 June 1997, 13,118,837 Fairfax shares were traded on ASX. Of that:

(a) Yellow Ridge purchased on ASX 6,700,000 Fairfax shares, and
(b) MLAF and / or MLAE on its behalf, sold on ASX 6,751,905 Fairfax shares in 72 parcels.

2.27 4,442,506 of the Fairfax shares sold on ASX by or on behalf of MLAF on 27 June 1997 were purchased on ASX on behalf of BIL.

2.28 The Fairfax shares sold on ASX by or on behalf of MLAF on 17, 24 and 27 June 1997 were sold by way of 231 on market trades with 26 buying brokers. Of those 231 trades, 67 were with brokers buying on behalf of BIL.

2.29 The Fairfax shares purchased in the name of Yellow Ridge on 27 June comprised about 0.89% of Fairfax shares. BIL was not obliged to, and did not, notify ASX of any increase in its relevant interest in Fairfax arising from the purchase referred to in paragraph 2.26(a).

2.30 The total percentage of Fairfax shares purchased by BIL subsidiaries on 17, 24 and 27 June was approximately 3%. However, as stated in paragraph 2.25, BIL had only notified ASX of a 2.11% increase.

2.31 The market had not been informed of the Harlesden Contracts nor was there any legal obligation on MLAF or Harlesden to inform the market at that time or at all that they had entered into those swap transactions.

2.32 The market price of Fairfax shares at all relevant times between 16 and 27 June 1997, exceeded $3.00 per share.

2.33 At no time did Merrill Lynch or BIL fail to give any notice of substantial shareholding or change in substantial shareholding as required by the Law.

3. Issues

There was no statement of issues agreed by all parties. In terms of regulation 38, the Panel accepted, for the purposes of conducting the Conference, that the relevant issues would be an amalgam of the statement of issues provided by the ASC, the joint statement of BIL and Merrill Lynch and the Panel's Brief.

The Panel identified the following issues for its determination:

3.1 whether the shareholders and directors of Fairfax did not know the identity of the BIL companies as persons who proposed to acquire Fairfax shares;

3.2 whether the shareholders and directors of Fairfax did not have a reasonable time in which to consider a proposal that the BIL companies acquire the Fairfax shares;

3.3 whether the shareholders of Fairfax did not all have reasonable and equal opportunities to participate in, or become entitled to participate in, any benefits accruing to any shareholder or any associate of a shareholder, in connection with the acquisition by BIL of the Fairfax shares;

> 3.3.1 whether a benefit accrued to any shareholder or any associate of any shareholder of Fairfax in connection with the acquisition by BIL of the Fairfax shares;
>
> 3.3.2 if so, what the nature of the benefit was and who it accrued to;
>
> 3.3.3 whether the shareholders of Fairfax had reasonable and equal opportunities to participate in, or to become entitled to participate in, that benefit;

3.4 whether the acquisition by BIL of the Fairfax shares was an acquisition of a substantial interest in Fairfax for the purposes of section 732 of the Law:

> 3.4.1 whether the acquisition of the Fairfax shares gave BIL control of Fairfax;
>
> 3.4.2 whether the acquisition by BIL of the Fairfax shares was a threat to the stability of corporate control of Fairfax;
>
> 3.4.3 the extent to which, if at all, an acquisition of shares authorized by section 618 of the Law can be regarded as infringing the Eggleston Principles;

in the context of:

(a) the BIL Purchases; and
(b) the combined economic effect of the BIL Purchases and the first three Harlesden Contracts; and

3.5 if the Panel is satisfied that unacceptable circumstances occurred in relation to the acquisition by the BIL Companies of the Fairfax shares, whether it is in the public interest and otherwise appropriate for the Panel to make a declaration that the acquisition was an unacceptable acquisition within the meaning of section 733(3).

4. The Law

4.1 The relevant parts of the Law:

Section 618(1)

"Section 615 does not prohibit an acquisition of voting shares in a company because of the effect of the acquisition on the entitlement to voting shares in the company of a person (in this section called a relevant person if:

(a) the relevant person has been entitled to not less than the prescribed percentage of the voting shares in the company for a continuous period of not less than 6 months ending on the day immediately before the day on which the acquisition takes place; and
(b) the number ascertained in accordance with the formula

$$\frac{100 (VA1 + VA2 - VD)}{V}$$

does not exceed 3."

Section 731

"In exercising any of its powers under section 728 or 730, the Commission shall take account of the desirability of ensuring that the acquisition of shares in companies takes place in an efficient, competitive and informed market and, without limiting the generality of the foregoing, shall have regard to the need to ensure:

(a) that the shareholders and directors of a company know the identity of any person who proposes to acquire a substantial interest in the company;
(b) that the shareholders and directors of a company have a reasonable time in which to consider any proposal under which a person would acquire a substantial interest in the company;
(c) that the shareholders and directors of a company are supplied with sufficient information to enable them to assess the merits of any proposal under which a person would acquire a substantial interest in the company; and
(d) that, as far as practicable, all shareholders of a company have reasonable and equal opportunities to participate in any benefits accruing to shareholders under any proposal under which a person would acquire a substantial interest in the company;

but nothing in this section requires the Commission to exercise any of its powers in a particular way in a particular case."

Section 732(1)

"For the purposes of this Part, unacceptable circumstances shall be taken to have occurred if, and only if:

(a) the shareholders and directors of a company did not know the identity of a person who proposed to acquire a substantial interest in the company; or
(b) the shareholders and directors of a company did not have a reasonable time in which to consider a proposal under which a person would acquire a substantial interest in the company, or
(c) the shareholders and directors of a company were not supplied with enough information for them to assess the merits of a proposal under which a person would acquire a substantial interest in the company; or
(d) the shareholders of a company did not all have reasonable and equal opportunities to participate in any benefits, or to become entitled to participate in any benefits, accruing, whether directly or indirectly and whether immediately or in the future, to any shareholder or to any associate of a shareholder, in connection with the acquisition, or proposed acquisition, by any person of a substantial interest in the company; or "

Section 733(3)

"Where, on an application under subsection (1); the Panel is satisfied:

(a) that unacceptable circumstances have occurred:
    (i) in relation to an acquisition of shares in the company; or
    (ii) as a result of conduct engaged in by a person in relation to shares in, or the affairs of, the company; and
(b) having regard to the matters referred to in section 731 and any other matters the Panel considers relevant, that it is in the public interest to do so;

the Panel may by writing declare the acquisition to have been an unacceptable acquisition, or the conduct to have been unacceptable conduct, as the case may be."

4.2 The Eggleston Principles

The underlying rationale of sections 731 and 732(1) rest on what have become known as the Eggleston Principles.

The Eggleston Principles were formulated in the Eggleston Report (Second Interim Report, February 1969 Command 144) which was a report to the Standing Committee of Attorneys-General relating to disclosure of substantial shareholdings and takeover bids. The report contains the following:

"Paragraph 16

We agree with the general principle that if a natural person or corporation wishes to acquire control of a company by making a general offer to acquire all the shares, or a proportion sufficient to enable him to exercise voting control, limitations should be placed on his freedom of action so far as is necessary to ensure:

(i) that his identity is known of the shareholders and directors;
(ii) that the shareholders and directors have a reasonable time in which to consider the proposal;
(iii) that the offeror is required to give such information as is necessary to enable the shareholders to form a judgement on the merits of the proposal and, in particular, where the offeror offers shares or interests in a corporation, that the kind of information which would ordinarily be provided in a prospectus is furnished to the offeree shareholders;
(iv) that so far as is practicable, each shareholder should have an equal opportunity to participate in the benefits offered."

The underlining is that of the Panel (refer to paragraph 6.8.3.)

5. Section 618

The operation of section 618 and Chapter 6 of the Law were discussed by Emmett J in the Judgment. The Panel adopts the view expressed by Emmett J in the Judgment at page 15;

"Having regard to the clear policy of section 618 arbitrary though it may be, the ASC and the Panel would be slow to make a declaration where an acquisition is made in accordance with section 618 and relates to a small proportion of the issued shares in a company. Nevertheless, I do not consider that, simply because conduct is authorised by section 618, it is not capable of constituting unacceptable circumstances."

The exception in section 618 of the Law is commonly referred to as the 3% creep rule. It is interesting to note in the Explanatory Memorandum to the Companies (Acquisition of Shares) Act 1981 (which has become known as CASA) there is no real discussion of the policy rationale for the 3% creep rule apart from noting that the effect is to impose a 6 month freeze.

In his book, The Proposed Take Over Code, 1979 -- An Explanation of the Changes, Mr AB Greenwood provides an explanation for the inclusion of the creep rule in an early draft of the CASA provisions;

"[The rule] gives limited scope for privately negotiated transactions or market dealing by major holders. The purpose of the formula set out in the section is to give effect to the concept that it is net gains of 5% that should be dealt with. The formula will avoid the situation that applies in the USA where the tender offer statute applies even if the acquisition was immediately followed by a reduction (American Pepsi Cola Bottlers Inc.)."

[5% was the percentage proposed in the CASA Bill at that time.]

The 3% creep rule was retained in the Law and there is no discussion of policy rationale for the retention of the rule in the Explanatory Memorandum to the Law.

Renard and Santamaria in their book Takeovers and Reconstructions in Australia Butterworths, paragraph 502, justify the 3% creep rule as follows:

"A patient major shareholder could over time gradually increase his holding to majority control by purchases on the share market, avoiding the premium which is normally payable by a bidder under a takeover scheme who is seeking control of the target."

6. Reasons for decision

6.1 Overview

BIL was entitled on 17 June 1997 or on subsequent days to enter the market and, either by private treaty, crossing on ASX or by market purchases acquire a further 3% of Fairfax shares. That was clearly a course of action permitted by law, and as the Panel understands the attitude of the ASC, it does not contend that if BIL had proceeded in that way then there would have been any unacceptable conduct.

What the ASC has considered was that unacceptable circumstances occurred when the market was unaware of the swap agreements (the Harlesden Contracts) which would induce Merrill Lynch to sell on the three specified days and BIL to buy on the same dates in the expectation that Merrill Lynch would be a seller. Further, the effective cost to BIL was $3 per Fairfax share compared with the prevailing market price.

Whatever views the Panel may have as to the acceptability or otherwise of the acquisition in the circumstances outlined above, the Panel is constrained by the definition of unacceptable circumstances in section 732(1). The Panel is of the view at the drafters of the provision did not contemplate the utilisation of swap agreements in the manner evolved by the market and the advisers to the Parties on the legality of the Harlesden Contracts.

The question for the Panel therefore is whether what occurred *can* fall within section 732(1).

6.2 It is conceded by the ASC, and indeed, there has been no allegation by the ASC generally or made out in the ASC Application, that by either:

(a) the entering into of the Harlesden Contracts; or
(b) the BIL Purchases

that there has been any breach of the Law.

6.3 In any event, the Panel is not to concern itself with any issue as to there being any breach of the Law but rather is confined to a determination as to whether unacceptable conduct occurred.

6.4 There has been much material put before the Panel in relation to the use of swap agreements, derivatives generally and hedging arrangements.

6.5 It has been suggested that the future use of derivatives in the marketplace, generally, could be affected by a declaration by the Panel. The Panel rejects that view.

6.6 lt is the operation and effect of the particular swap agreements, namely the Harlesden Contracts, with regard to the BIL Purchases, and of conduct engaged in, that is the only relevant matter for determination by the Panel.

6.7 The Panel considered:

(a) the ASC Application;
(b) the Panel's Brief dated 22 August 1997;
(c) the submissions of the ASC, BIL and Merrill Lynch;
(d) the rebuttal submissions of the ASC, BIL and Merrill Lynch;
(e) the agreed statements of material facts lodged by the ASC and Merrill Lynch / BIL;
(f) the statements of issues lodged by the ASC and Merrill Lynch / BIL;
(g) the evidence taken and addresses given by Counsel at the Conference convened by the Panel; and
(h) the ASC's further submissions handed up at the conclusion of the Conference on 23 September 1997 and the rebuttals delivered by BIL and Merrill Lynch on 24 September 1997 in response to the ASC's further submissions.

6.8 The relevant Law

Section 733(3) of the Law requires the Panel to be satisfied that unacceptable circumstances have occurred:

(a) in relation to an acquisition of shares in Fairfax; or
(b) as a result of conduct engaged in by a person in relation to shares in, or the affairs of, Fairfax.

It is conceded by all parties that the Panel in making its determination under section 732(3)(a) must first determine whether unacceptable circumstances occurred within the meaning of section 732(1) of the Law.

The High Court of Australia put it this way in Precision Data Holdings Ltd v Wills, Adler and Jooste (in their capacity as members of the Corporations and Securities Panel) (1992) 10 ACLC 1 at 7; (1991) 173 CLR 167 at 187.

“It is evident that s. 733(3)(a), in requiring the Panel to be satisfied of the occurrence of unacceptable circumstances before declaring the acquisition or conduct in question to have been unacceptable, required the Panel to make findings of fact. Additionally, s. 733(3)(b) required the Panel to have regard to the matters set out in s. 731.”

(Underlining is by the Panel)

Also, the Panel refers to the Eggleston Principles.

6.8.1 Substantial interest

The relevant subsections of section 732(1) require the Panel to determine that the relevant share acquisition or conduct under section 733(3)(a) relate to a substantial interest in the company.

In making its determination that a substantial interest has been made out in terms of the relevant sections, the Panel notes, and the Parties accept, the term is not defined in the Law.

The Panel had regard to the decision of Marks J. in Elders IXL Ltd v National Companies and Securities Commission (1986) 4 ACLC 465; (1987) VR 1 (which was adopted by Emmett J. in the Judgement) set out below:

His Honour said (at ACLC 477-478; VR 17-18);

“It is unnecessary to give definitive meaning to the expression substantial interest in the subsection. At the very least, in my opinion, it must be understood in the context of the Takeovers Code. It may well be that its meaning cannot be defined by reference to a stated percentage or a minimum percentage, but that the question as to what is or is not a substantial interest for the purposes of the subsection is to be determined according the circumstances of a particular case. But its meaning in a particular case must attach to a step in the direction of take-

over or change in corporate control. It is not to be considered in a vacuum as relating solely to size. The size must have relationship to a threat or potential threat to the stability of corporation control."

Emmett J. in the Judgement went on to say (page 10):

"As a matter of language, therefore, I consider that an interest not greater than 3% is capable of being a substantial interest."

Without limiting the adoption by the Panel of the above judicial determinations, the Panel had regard to the following:

- BIL prior to the June acquisitions owned 19.98% of Fairfax;
- there is incontroverted evidence that BIL had announced its intention to creep to 25% (refer to press announcements by BIL -- ASC Application Tab 4);
- there is press commentary quoting a Director of BIL, Mr Price, that BIL will go to 49% if the relevant approvals were obtained and in particular, the restriction currently imposed by the operation of the Foreign Acquisitions and Takeovers Act (refer to press material -- ASC Application Tab 4);
- considerable press material was put before the Panel in relation to the Hollinger interests being in effective control of Fairfax with its then holding of 25% (refer press material ASC Application Tab 1); and
- these comments, although only attributed to press comments or reports, were made by senior and well recognised financial journalists commenting on the market.

The Panel, relying on its own judgment, formed the view that the BIL Purchases constituted a substantial interest.

The Panel's determination is supported by the judicial authorities (quoted above) and the material put before the Panel.

6.8.2 Section 732(1)(a)

The ASC almost conceded that it was not pressing its application in terms of this section. The Panel finds there is an abundance of evidence before the Panel which clearly establishes that, assuming there was some form of proposal, the identity of the person intending to acquire an additional interest under the creep provisions was well known to the market.

Further, for the reasons set out in paragraph 6.8.3, the Panel also finds there is no proposal. Accordingly, the Panel determines that unacceptable circumstances have not occurred within the meaning of section 732(1)(a).

6.83 Section 732(1)(b)

The threshold issue for determination by the Panel under this section is whether there existed a proposal. The Panel was invited to consider various constructions of the term proposal.

Counsel for the ASC suggested the term should be given its ordinary meaning. The Shorter Oxford Dictionary provides:

"Proposal:1The action or an act of stating or propounding something

2An act of proposing something a course of action etc. proposed; a scheme, a plan, a motion; a suggestion, an idea ..."

Counsel for BIL and Merrill Lynch submitted that section 732(1)(a) and the other paragraphs insofar as they refer to the proposals and the opportunity for shareholders and directors to

consider proposals, cannot have any application where what is happening is an acquisition pursuant to the provisions of the creep allowed by section 618.

The Panel refers to the *general principle*, set out in the Eggleston Principles (refer to paragraph 4.2). That *general principle*, as there enunciated, relates to the making of a general offer to acquire all the shares, or a proportion sufficient to enable the exercise of voting control. The Panel considers this *general offer* is what is meant by *proposal* in sections 731 and 732.

This being the case, then sections 732(1)(a) to (c) have no application as the B1L acquisition is made under the creep provisions of section 618 and is not accompanied by a general offer.

The Panel considers the ASX market activity relevant to the Harlesden Contracts, on 17, 24 and 27 June 1997, through the SEATS trading was not abnormal and all persons as well as Merrill Lynch and BIL were afforded the opportunity of trading in Fairfax shares on that day. The transactions were done on market. The market became aware of the BIL purchasing activities during the course of trading on 17 June and subsequent activities on 24 and 27 June 1997. The Panel accepts the evidence of Keene at paragraphs 14-17. Also, these activities were widely commented upon in the press (refer press material submitted by BIL at the Conference).

Accordingly, the Panel determines that unacceptable circumstances have not occurred within the meaning of section 732(1)(b).

6.8.4 Section 732(1)(c)

The Panel finds that from all of the relevant material and facts before it that it was clear on any construction of those facts that the Directors and shareholders of Fairfax knew or ought to have known that BIL intended to creep immediately it was in the position to do so under the Law.

Further, for the reasons set out in paragraph 6.8.3., the Panel also finds there is no proposal. Accordingly, the Panel determines that unacceptable circumstances have not occurred within the meaning of section 732(1)(c).

6.8.5 Section 732(1)(d)

The Panel considers there are several key components of this section which need to be identified and considered:

- *all* shareholders
- reasonable and *equal opportunities to participate* (or entitled to participate)
- in *benefits in connection with the acquisition*, or proposed acquisition
- substantial interest (which the Panel has already determined above)

This section adopts the fourth Eggleston Principle. The Panel is of the view that the critical element for meeting the fourth Eggleston Principle is whether there is a proper basis for determining that all shareholders were denied the opportunity of participating (or being entitled to participate) in any benefits in connection with the acquisition (the BIL Purchases).

The Panel has evidence of the actual ASX trades in Fairfax shares for the period December 1996 to the end of August 1997. These facts are and have been on the public record and available to all. During the course of the Panel's Conference, and in the submissions and other material put before the Panel, all parties have discussed hypothetical scenarios. There are competing opinions as to the likely effect on the market of these hypothetical scenarios.

Therefore the Parties and the Panel can only speculate as to what might have happened or could have happened with the Fairfax share price in any one of these scenarios.

As Mr Bunn (BIL witness) said:

"No-one's bigger than the market"

[Transcript p 188 lines 35/36].

The market is driven or affected by many factors including:

- in anticipation of a party exercising its rights to a creep there is an expectation of an increase in the market price. (refer Keene transcript p 283 lines 4-9);
- conversely, within the same scenario as above, some observers are of the view that the market price reaches a point at which it is fully priced and will create selling pressure;
- also, at the same time, some observers or participants in the market may conclude that the creep will not occur and will become sellers forcing down the price;
- the market reacts to the activity of speculators;
- the market is reacting to perceptions of likely announcements in relation to changes in the media ownership laws;
- a highly traded stock such as the Fairfax shares may react to general movements in the All Ordinaries Index or other economic factors independently of that Index; and
- all evidence before the Panel speaks of the Fairfax stock being deep, liquid and broad, for example, see Keene at paragraph 16 of his statement.

The Panel has formed the view that even if the market had been aware of the Harlesden Contracts, the market would not have reacted materially differently. In support of the view, the Panel notes no evidence was adduced of any identified benefits.

It should be clearly understood that the Panel formed the view above relying on its own judgment and assessment of the relevant facts before it, noting the absence of any evidence or other relevant material put before it which identified that there were any benefits (whether positive or negative), which flowed to BIL from the acquisition within the meaning of the section.

The Panel should record that the Panel received *no* submissions from Fairfax, any director of Fairfax ASX, any shareholder body or any past, present or future shareholder complaining as to the market forces which operated on the Fairfax ASX share price on the relevant days in June. The Panel is entitled to conclude that in the absence of such submissions, interested parties and the market generally did not identify that there were any *missed* or *lost* benefits.

Therefore, the Panel finds that there were no benefits within the meaning of section 732(1)(d) and, accordingly, determines that unacceptable circumstances have not occurred within the meaning of section 732(1)(d).

6.8.6 The Panel considers that its determination in paragraph 6.8.5. that the BIL Purchases made at a time when the Harlesden Contracts operated as swap agreements do not constitute unacceptable conduct, must be seen in the light of the particular facts and circumstances pertaining to Fairfax, including:

- Fairfax shares are a highly traded stock on ASX;
- Fairfax is seen in the market as a leader;
- there are a large number of Fairfax shareholders;
- Fairfax has a large market capital; and
- it is recognized as a leading Australian company in the media sector of the market.

In the converse, the operation of swap agreements may well constitute unacceptable conduct if the company was much smaller and had a lower traded stock base or where circumstances were materially different.

Further the Panel has considered the economic incentives said to exist for Merrill Lynch to sell on the Valuation Dates. The Panel is of the view that there was an economic, financial and / or commercial incentive to do so on the following assumptions including:

- if Merrill Lynch considered the market price would not increase;
- if Merrill Lynch's corporate policy was risk averse;
- if there was no prospect of a take out party.

The Panel has considered the relevance of this issue in coming to its determination.

6.8.7 Conclusions on section 732(1)

The Panel, in regard to the matters referred to the Panel by the ASC Application, determines and finds that unacceptable circumstances have not occurred within the meaning of section 732(1)(a) (b) (c) or (d) of the Law.

Accordingly, the Panel is not satisfied that unacceptable circumstances have occurred within the section 733(3) of the Law. Further, in any event, the Panel would have declined to make any declaration under section 733(3) if the answer as to the existence of unacceptable circumstances had been any different.

6.8.8 The Panel under the heading Observations and Recommendations comments on the issue of derivatives and their future use in both takeovers and creep situations.

The overriding concern of the Panel is that there should be an efficient, competitive and informed market.

7. Discretion under the second limb of section 733(3)

7.1 Even though the Panel has made its determination that unacceptable circumstances have not occurred within the meaning of section 732(1), the Panel wishes to also deal with the discretions in section 733(3) as if it were in a position to make a declaration.

If the Panel is found to be wrong or to have erred in its determinations as to the operation and application of section 732(1)(a) (b) (c) or (d) then the Parties and the market should clearly understand that the Panel's view is that it would have declined to make a declaration under section 733(3) even if it had been in a position to identify and determine unacceptable circumstances within section 732(1).

7.2 The Panel is of the view that, notwithstanding the need to have regard to the matters in section 731, no declaration would have been made under section 733(3) because it is not satisfied on the evidence or the submissions made that it would be in the public interest to do so when particularly the BIL Purchases all occurred on market. The evidence before the Panel indicates the BIL Purchases made no appreciable impact on the Fairfax ASX share prices during the period of June to August 1997. Also, the market was aware of the BIL activity during the day of 17 June as widely reported in the financial press the following day.

7.3 Section 733(3) of the Law provides that the Panel is only entitled to make a declaration if it finds it to be in the public interest that such a Declaration should be made. Section 731 makes it clear that it is in the public interest for acquisitions of shares to take place in an efficient, competitive and informed market (the Eggleston Principles).

7.4 In the Panel's view, the disclosure of the Harlesden Contracts, and their operation as swap agreements, would not have had any material effect, in terms of market price on Fairfax stock during the relevant periods in June.

8. Panel's observations and recommendations

8.1 Observations

The legislative provisions governing the Panel created a difficult environment within which the Panel was required to discharge its functions. What follows should not be taken as any criticism or implied criticism of the Parties or their legal representatives but rather seen as an objective commentary on the Panel's workings.

The Panel's procedures are, at best, a hybrid of procedures. On the one hand, the Panel is required to apply its specialist knowledge to the material which is before it and, on the other hand, it is subjected to the provisions of the Administrative Decisions (Judicial Review) Act 1977 and the Judiciary Act 1903, so that it is a hybrid procedure, partly legal, partly administrative, partly inquisitorial and partly adversarial. The observations of the High Court of Australia in the Precision Data decision on the workings of the Panel are apposite.

A unique aspect of the Panel's jurisdiction is said to be that it examines infringements of the *spirit* of the Law and not *actual* breaches of that Law. The ASC Regulations (regulation 16(3)) states the procedures followed in an Inquiry conducted by the Panel are to be fair and reasonable, conducted with as little formality and in as timely a manner as the Law and a proper consideration of the matters before the Panel permit.

As noted earlier in the Panel's Reasons, this matter became very legalistic. The Panel observed that, rather than the Panel having the intended benefit of the relevant legislative provisions in dealing directly with the Parties concerned, the Conference was required to be conducted in a matter which was entirely legal in nature because of the need to comply with the relevant procedural fairness and natural justice issues. Also, in some way, the Federal Court Proceedings set the scene.

The Panel is of the view that future conferences should be conducted in a more commercial manner. Particularly, as has been the subject of recent media comment if the powers of the Panel are to be expanded to take a more interventionist role in current takeover matters, similar to that undertaken by the UK Takeover Panel. In the Panel's view, much of the short time available to it to consider the matters raised by this referral were taken up with overbearing procedural issues and debate rather than concentrating on the substantive issues. This was not the intention of Parliament and the legislative framework clearly requires further amendment to ensure that the expressed intention is given effect to.

Market knowledge of swap agreements could have an impact on an efficient, competitive and informed market. Desirably, in a fully informed market, swap agreements should be disclosed.

8.2. Recommendations

The Panel is of the view that the procedural provisions within the legislative framework needs significant reform. These reforms range from some clarification amendments (such as the need to clarify which Panel is referred to once the President has constituted a Panel under section 184 of the ASC Law for a particular reference) to much more substantive amendments, the subject of our earlier comments. The most pressing need for legislative amendment is in the role of the Panel to ensure that it is conferred with greater powers to conduct inquiries without those inquiries becoming unduly legalistic. Again, this is not intended as any criticism of the Parties in this matter nor of their legal representatives or counsel. Rather it is a criticism of the legislative structure and framework within which the Panel must work. The Panel is of the view that legal representation should not be denied to the parties but the parties must be the only persons entitled to address the Panel (with legal advice available) so that there will be direct dialogue between the relevant players and the Panel members as to the matters referred to the Panel.

Suitable protection provisions similar to those given to ASC examinations (confidentiality provisions and the like) should be included.

Further, if it is the intention of the legislature that the Panel should play a more interventionist role in takeover situations then the current legislative provisions need revision to facilitate this. It could be suggested that the legislation suffers from its prescriptive nature. Rather it should, in adopting the Eggleston Principles, set the standards to be followed in all takeover and other regulated share acquisition situations (e.g. the creep provision) so that anything short of those standards could be investigated immediately by the Panel, in a quick manner with appropriate orders or declarations.

It should be noted, and the High Court in the Precision Data decision agreed, that the drafting of section 732(1), in meeting the first limb of section 733, does not incorporate the critical, and in the Panel's view, overriding consideration to be that of there being an efficient, competitive and informed market. The reference in the second limb of section 733 to section 731 does not overcome the problem.

Also, there is a pressing need for parties or other affected parties to be able to refer matters directly to the Panel (without reference to the ASC). The ASX should be given the right to refer appropriate matters to the Panel. Consistent with the above recommendations, the Panel will need a clearly expressed formulation of its policy making role rather than relying on the Precision Data decision.

The Panel notes that, in addition to the concerns expressed by the Parties in this application, there has been considerable comment in the financial press *that there is an urgent need for a clear policy formulation* to remove any uncertainties that might exist in the market place as to the use of derivatives in relation to takeovers and other share acquisitions. The Panel recommends that a clear policy be formulated in this regard.

9. Conclusions

9.1(a) As determined in paragraph 6.8, the Panel is not satisfied that unacceptable circumstances, as set out in the ASC Application, occurred under section 733(3) of the Law.

(b) Even if the Panel had found unacceptable circumstances occurred, the Panel would have declined to make a declaration under section 733(3) for the reasons given in paragraph 7.

(c) The Panel makes the following recommendations:

1 The Panel is of the view that the legislation is in urgent need of reconsideration. The reconsideration ranges from substantive to procedural matters.

2 As the Panel indicated, there may be an argument for suggesting that instead of the constraints of the Eggleston Principles in sections 731(1) and 732(1), unacceptable conduct is defined in more general terms in order to allow Panels to consider transactions effected in the commercial and financial setting which has developed since the Eggleston Principles were formulated.

Decision:

1. The Panel is not satisfied that unacceptable circumstances have occurred:

(a) in relation to an acquisition of shares in John Fairfax Holdings Ltd; or
(b) as a result of conduct engaged in by a person in relation to shares in, or the affairs of, John Fairfax Holdings Ltd

as claimed in the Application of the Australian Securities Commission dated and lodged with the Corporations and Securities Panel on 15 August 1997.

2. The Panel further finds that, in any event after having regard to the facts and circumstances of this Application and having regard to the matters referred to in section 731 of the Corporations Law and other relevant matters considered by the Panel, it would not be in the public interest to make a declaration as sought by the Australian Securities Commission pursuant to section 733(3) of the Corporations Law.