



Monday, 10 September 2007

Equity Derivatives - Draft Guidance Note for Discussion

The Takeovers Panel has today released a draft Guidance Note, and discussion paper, seeking public discussion and comment on the approach which the Panel proposes as to when, and in what circumstances, the use of equity derivatives may constitute unacceptable circumstances. The purpose of the draft Guidance Note is to facilitate discussion among, and obtain feedback from, market participants and investors who may be affected by any guidance which the Panel publishes on equity derivatives, or otherwise have an interest in such guidance.

The central proposition is that for control and substantial holding disclosure purposes, at least, long equity derivatives (cash settled or deliverable) should be treated the same as physical holdings of the relevant securities.

The draft Guidance Note follows a number of significant developments in takeovers law and regulation in Australia over the last two years, including:

- the Panel's decisions in the *Austral Coal* proceedings¹;
- the Court's decisions in the *Glencore* litigation² and in the *Australian Pipeline Trust* litigation³;
- the commencement of the Corporations Amendments (Takeovers) Act 2007 (*Cth*) on 13 May 2007.

The Panel notes similar regulatory developments in the United Kingdom with the amendments to the London City Code on Takeovers and Mergers in 2006.

The draft Guidance Note is open for comment for 12 weeks. The Panel will publish the results of this consultation process, including the main suggestions received, the changes made as a consequence, and the reasons the Panel takes up, or does not take up, submissions. **Responses are due by 07 December 2007.**

¹ [Austral Coal 02 \[2005\] ATP 13](#); [Austral Coal 02\(R\) \[2005\] ATP 16](#)
[Austral Coal Limited 02\(RR\) \[2005\] ATP 20](#)

² [Glencore International AG & Anor v Takeovers Panel & Ors \[2005\] FCA 1290](#)
[Glencore International AG \(ACN 114 271 055\) v Takeovers Panel \[2006\] FCA 274](#)

³ [Australian Pipeline Limited v Alinta Limited \[2007\] FCAFC 55](#)
[Australian Pipeline Limited v Alinta Limited \[2006\] FCA 1378](#)

In essence the Panel's discussion Guidance Note indicates that:

- when considering whether or not unacceptable circumstances exist, the Panel will normally treat a person's long equity derivative interests and voting power in listed entities in a combined manner (**Combined Holding**);
- persons considering disclosure of their interests in listed entities should look to their Combined Holding and disclose a Combined Holding that would meet the shareholder disclosure thresholds in Chapter 6C.2 if the person held a relevant interest in all of the securities to which the Combined Holding relates;
- when considering whether or not unacceptable circumstances exist the Panel is unlikely to look through a person's equity derivative holding to determine whether or not the equity derivative they hold is fully or substantially hedged by the underlying securities, nor whether or not the holder of the equity derivative was aware of the hedge status of the equity derivative;
- the Panel does not consider it appropriate to require disclosure of "short" equity derivative interests in the absence of any other Combined Holdings which would trigger disclosure obligations;
- the Panel considers that it would be inappropriate to "net off" long and short equity derivative positions against each other or against physical holdings when calculating a person's Combined Holding.

Background

The area of equity derivatives came to the attention of the Panel in late 2004 and early 2005 and the Panel commenced consideration of the issues in early 2005. Items which came into the public domain over that period included:

- In early 2005 the Code Committee of the London Takeover Panel published a Public [Consultation Paper](#) entitled "Dealings in Derivatives and Options" (7 January 2005). The changes proposed in the Consultation paper were introduced in November 2005.
- In February and March 2005 there was media comment on the acquisition of 11 per cent of Portman Limited during Cleveland Cliffs' takeover offer which was discussed as potentially being related to an equity derivative contract.
- In March 2005 BHP Billiton disclosed that it had acquired an economic interest in 4.3 per cent of WMC Ltd via an equity derivative leading up to BHP's successful takeover offer for WMC.

It was agreed by the Panel's members that the Panel should develop some Panel guidance on this area to assist the market. Given the complicated nature and structure of derivatives contracts, it was suggested that the guidance committee include at least one representative from the derivatives market.

Since that time there has been regular commentary in the media concerning the use of equity derivatives in takeover situations both in Australia and overseas in a number of high profile takeover bids.

Why did the Panel decide to draft a guidance note on equity derivatives?

The Panel was conscious that equity derivatives were being increasingly used by potential bidders, and by speculators such as hedge funds, in respect to target shares prior to the announcement of, or during, a takeover, both in Australia and overseas. The Panel was concerned that equity derivatives should not be used in ways that undermine the policy of Chapter 6 or avoiding the provisions of Chapter 6-6C. The Panel considered that it would be desirable for it to give some guidance as to when, and in what circumstances, the use of equity derivatives may constitute unacceptable circumstances. Such guidance would also assist bidders and other persons as to measures that they might take to reduce any risk that conduct they take in relation to equity derivatives would give rise to unacceptable circumstances.

The Panel emphasised in its discussion document that it does not wish to disrupt, or place unreasonable restrictions on the equity derivative market in Australia. The Panel considers that the approach which it is proposing for discussion in its draft Guidance Note will affect a very small percentage of equity derivative transactions in Australia, and the costs imposed on these types of transactions are reasonable and measured when assessed against the benefits of an efficient, competitive and informed market as a whole.

The Panel noted that even after it develops a final document following the discussion process its document will continue to be a work in progress and that the Panel will monitor the equity derivative market in Australia closely to see how its guidance is working in light of developments in the market.

Key points on which the Panel seeks comment from market participants:

The Panel is particularly interested in public comment on:

- the fundamental concept of treating a person's long equity derivative interests and voting power interests together as a Combined Holding when considering whether or not unacceptable circumstances exist;
- the appropriate amount and nature of disclosure which is required in relation to equity derivatives, and the appropriate method and channel for that disclosure;

- whether there should be any netting of a person's Combined Holding with any short equity derivative positions or short physical positions they hold;
- whether the Panel should normally consider whether the writer of an equity derivative has hedged that derivative, the form of hedging, the knowledge of the holder of the equity derivative of that hedging (if any), or the purpose for which the equity derivative was entered into;
- the appropriate disclosure of short physical positions and short equity derivative positions;
- the appropriate treatment of equity derivatives in relation to beneficial ownership notices;
- whether the fact that equity derivatives have been entered into in the context of a control transaction, should be of deciding importance in any decisions of the Panel;
- the costs of compliance with the Panel's proposed guidance; and
- whether the Panel's proposed guidance will have any adverse effect on the market for equity derivatives in non-control circumstances.

The Director of the Panel noted the Panel's gratitude to the members of the sub-committee who had contributed to the development of the Guidance Note. The Panel's sub-committees include both Panel members and members of the takeovers and investment markets. Mr Morris said that the Panel very much appreciated the sub-committee members who give their time generously, and their organisations who support them⁴, to assist the Panel produce better quality documents.

External Members

Andrew Williams &
Christopher Madden

UBS

Panel Members

Garry Besson

Gilbert & Tobin

⁴ Sub-committee members contribute in their personal capacities and the draft Guidance Note, while being a formal document of the Panel, does not, and should not be taken to, represent the views of the firms with whom individual sub-committee members are associated.

Denis Byrne	Company Director
Hamish Douglass	Magellan Financial Group
Alastair Lucas	Goldman Sachs JB Were
Andrew Lumsden	Corrs Chambers Westgarth
Chris Photakis	Pitt Capital Partners

The draft Guidance Note is available on the Panel's website on the [Consultation page](#). The Panel is seeking comments on the draft Guidance Note by **Friday 07 December 2007**.

It is the Panel's policy to publish or otherwise make available all responses to formal consultation, unless respondents indicate that they do not consent. It is also the Panel's policy to publish a "Consultation Response" document after the consultation period setting out the main comments that the Panel has received and the reasons why the Panel has taken up, or not taken up, the comments or suggestions received.

Comments should be addressed to the Panel's Director and Counsel, Mr Nigel Morris and Mr Alan Shaw at takeovers@takeovers.gov.au.

Nigel Morris
Director, Takeovers Panel
Level 47, 80 Collins Street
Melbourne, VIC 3000
Ph: +61 3 9655 3501
nigel.morris@takeovers.gov.au