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Imitation Food In An Imitation Kitchen by Laura Oczosty

EQUITY DERIVATIVES: COLLATERAL DAMAGE

How a beneficial ownership register proposal could impact the ability to acquire a listed company.

What do tax reforms and equity derivatives have in common? Nothing. And yet, in November 2024, *Treasury released the exposure draft of the Treasury Laws Amendment Bill 2024: Enhanced disclosure of ownership of listed entities* (**Bill**). The Bill was introduced off the back of an election commitment by the Albanese Government to implement a public registry of beneficial ownership – proposed as part of a global initiative to ensure multinationals pay their fair share of tax.[1]

Put simply, the proposed reforms involve extending the concept of "relevant interest" to include derivative-based interests, irrespective of the settlement method or whether the writer has a relevant interest in the underlying securities. This change will have a profound impact on takeovers laws as bidders will be prevented from acquiring a more than 20% interest in a listed company, even if the interest is purely cash settled.

We're left scratching our heads as to how a proposal to introduce an ultimate beneficial ownership register, announced in the context of tax reforms, has resulted in proposed laws which affect the ability of a person to acquire a listed company.[2]

HOW DID WE GET HERE?

The use of equity derivates, particularly in control transactions, has attracted increased attention over the last few years. One of the more high-profile recent examples was Galipea Partnership (**Galipea**), an entity associated with Mike Cannon Brookes, building a stake in AGL Energy Limited (**AGL**) to block the proposed demerger of AGL[3]. Galipea's holding position became the subject of forensic analysis by the media to determine whether Galipea actually had the ability to vote down the proposal.[4] Galipea was initially described as "holding" a 11.28% interest in AGL (being a relevant interest in 8.44% in AGL and an economic interest in an additional 2.84%), through a combination of a cash settled total return swap and a collar.[5] Galipea subsequently announced that it had "simplified" its arrangements and (at the time of that updated notice) held a relevant interest in 11.28% in AGL.[6]

Understandably, high-profile uses of equity derivatives and recent Takeovers Panel[7] decisions have sharpened the focus on the use and disclosure of equity derivatives.

Under the current law, the "taker" of an equity derivative may not have a "relevant interest" in the underlying securities for the purposes of the *Corporations Act 2001* (Cth) (**Corporations Act**) either at all, or not until the taker has a right to acquire the underlying securities. A purely cash settled derivative does not therefore result in the taker having a relevant interest in the underlying securities, and disclosure by the taker is not required under Chapter 6C of the Corporations Act. However, Guidance Note 20: Equity Derivatives issued by the Takeovers Panel (**GN 20**) requires a person to disclose its long position (including a long equity derivative position – even if only cash settled, a relevant interest in securities or a combination of both) of 5% or more (and subsequent movements of 1% or more).

1. https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/media-releases/beneficial-ownership-register-consultation.
2. Or any company governed by Chapter 6 of the Corporations Act.
3. Disclosed the relevant interest acquired pursuant to a loan and equity collar transaction, additional shares acquired through a cash settled TRS. Also disclosed an additional cash settled option that didn't increase its relevant interest by still "noted".
4. https://www.smh.com.au/business/companies/expert-warns-cannon-brookes-share-tactics-could-derail-his-agl-play-20220510-p5ak3t.html.
5. https://www.aspecthuntley.com.au/asxdata/20220502/pdf/02517215.pdf#search=%22%22.
6. https://www.aspecthuntley.com.au/asxdata/20220518/pdf/02522798.pdf#search=%22%22.
7. Both in the context of control transactions (*Pacific Smiles Group Limited* [2024] ATP 12) and shareholder activist campaigns (*Whitehaven Coal Limited* [2023] ATP 12).

THE GIST OF THE CHANGES

Amongst other matters, the Bill proposes to amend the Corporations Act to deem the following derivative-based interests as "relevant interests":

- interests arising from physically settleable derivatives, regardless of whether the counterparty has a relevant interest in the underlying securities – referred to in the Bill as "*deemed physically settleable derivative-based interests*"; and
- interests arising from non-physically settleable derivatives – referred to in the Bill as "*deemed non-physically settleable derivative-based interests*".

For the purposes of "deemed non-physically settled derivative-based interests", the number of securities the person is deemed to have a relevant interest in will be specified, or calculated in accordance with a method specified, in a determination made by ASIC. As at the date of this article, ASIC is yet to publish or articulate it's intended approach. There's a very real question as to how ASIC will approach calculations in the context of holdings through index related products and other "bundled" financial instruments.

The Bill otherwise defines relevant interests in derivatives under the existing law as "*relatable derivative-based interests*" on the basis that those interests relate to a particular holding. There's a joke in there somewhere about these reforms not being relatable.

The Bill therefore articulates three categories of derivative interests:

1. relatable derivative-based interests;
2. 2deemed physically settleable derivative-based interests; and
3. 3deemed non-physically settleable derivative-based interests.

There are two key consequences of the changes proposed by the Bill in the context of control transactions.

THE 20% RULE

As the Bill extends the concept of "relevant interest" to include deemed derivative-based interests, those derivative-based interests will count toward the 20% threshold for the purposes of section 606 of the Corporations Act.[8] This is an incongruous result given the 20% threshold is centred on the concept of "voting power", and not mere economic interests.

GN 20 already states that the acquisition of a long position that would contravene section 606 of the Corporations Act if it were comprised entirely of a physical holding may give rise to unacceptable circumstances.[9] The Takeovers Panel has broad discretion in considering whether unacceptable circumstances exist – including accounting for the extent to which the taker has attempted to exercise control or influence over the relevant entity.

This is where the rubber really hits the road. A person could breach the 20% threshold by holding only an economic interest in the relevant entity and have no actual ability to control the voting or disposal of securities in that entity.

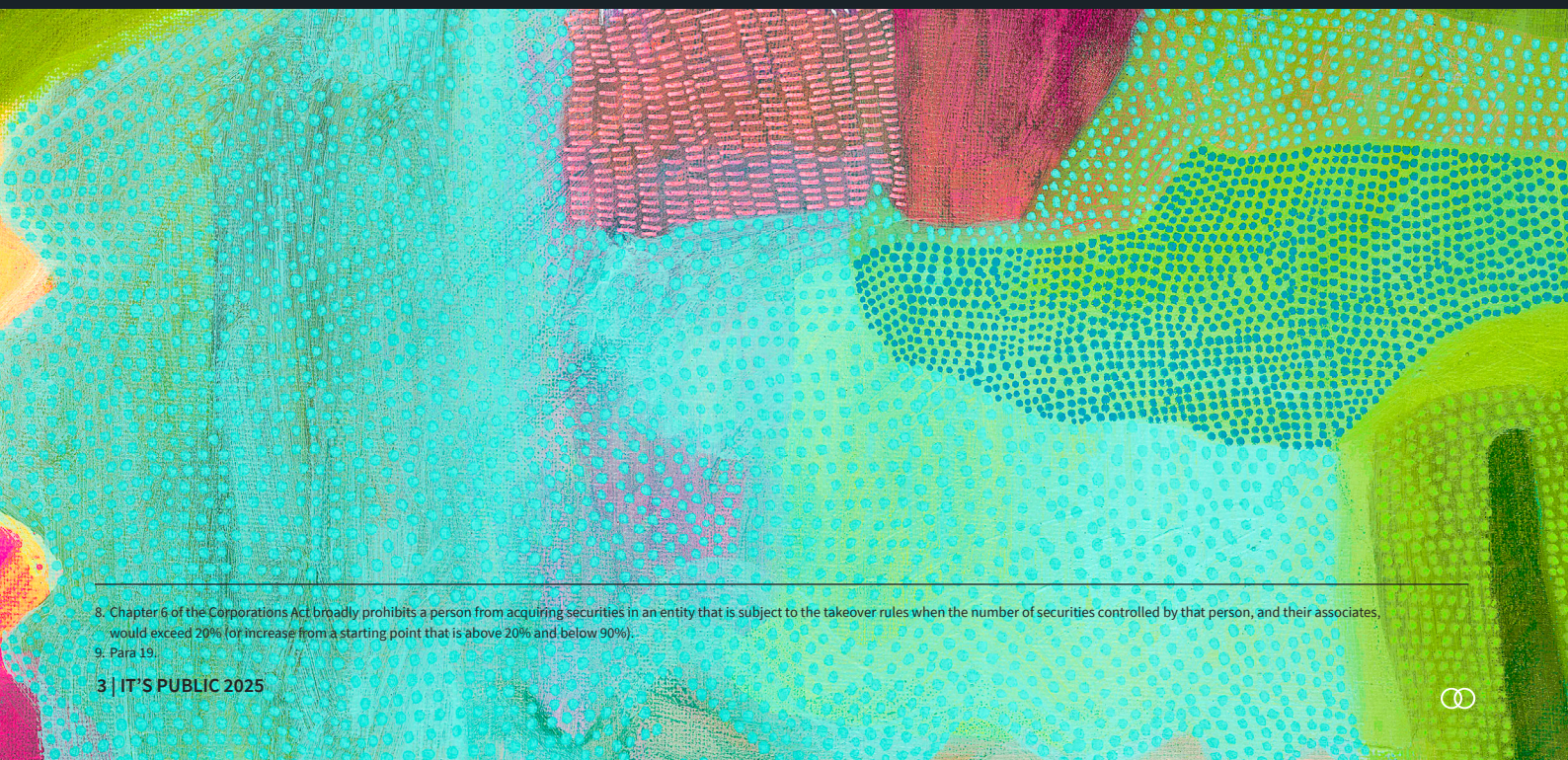
It's not clear why potential tax reforms have led to such a fundamental change to Australian takeovers laws.

Substantial holder notices

For the purposes of substantial holder notices, a person will need to aggregate their interests across all three derivative-based interest categories, and their non-derivative-based interests (i.e. actually holding shares) in calculating whether the 5% threshold is achieved.

The Explanatory Memorandum accompanying the Bill (EM) states that each type of interest will be separately identified in any substantial holding notice.

The EM notes that the proposed extension of disclosure requirements would be consistent with the approach taken in GN 20. However, the EM doesn't articulate why the Bill is required in light of the existing provisions of GN20.



8. Chapter 6 of the Corporations Act broadly prohibits a person from acquiring securities in an entity that is subject to the takeover rules when the number of securities controlled by that person, and their associates, would exceed 20% (or increase from a starting point that is above 20% and below 90%).
9. Para 19.

Notwithstanding the overlap with GN 20, revising the approach to substantial holder notices vis-a-vis derivative positions has merit.

Over disclosure of an economic interest in a listed company has the potential to mislead the market. In the AGL example, it may not have been readily apparent to a person not well versed in sophisticated financial instruments that Galipea did not initially have 11.28% voting power in AGL. Over disclosure of an interest in the context of a control transaction could mislead market participants to conclude that a potential bidder has the power to block a control transaction even when it doesn't actually control the votes to do so.

Under disclosure can be equally misleading – a key theme in most of the decisions by the Takeovers Panel concerning the disclosure of economic interests. Most recently, NDC (a Crescent Capital vehicle) effectively argued in Pacific Smiles Group Limited [2024] ATP 12 that had it been fully informed of the content of agreements underlying the economic derivative position held by the Genesis Capital managed bid vehicle, NDC may have decided (amongst other potential courses of action) not to proceed with its scheme to acquire Pacific Smiles.

Requiring substantial holder notices to clearly set out the economic interests by the holder is consistent with ensuring there is an efficient, competitive and informed market. The enhanced and clearer approach to disclosure could, however, be achieved through the substantial holder provisions and without amending the definition of "relevant interest" which has broader implications as discussed above.

WHERE TO NEXT?

The consultation period in respect of the Bill has closed. Submissions are yet to be made public but should make for a good read. Should the Bill remain on the legislative agenda of whoever forms the next Federal Government, our two cents: the enhanced disclosure proposals for substantial holder notices have merit but should ditch the fundamental change to the 20% prohibition.

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