Law Council
OF AUSTRALIA

Business Law Section

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Department of Industry, Science, Energy and Resources
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By email: paul.trotman@industry.gov.au

Dear Mr Trotman,

Offshore Petroleum and Greenhouse Gas Storage Amendment (Titles Administration and Other Measures) Bill 2021 - Change in control provisions

This submission concerning the *Offshore Petroleum and Greenhouse Gas Storage Amendment (Titles Administration and Other Measures) Bill 2021* is made by the Business Law Section of the Law Council of Australia (the **BLS**).

We wish to raise a number of issues with the Bill that we consider will give rise to unintended and commercially inconvenient consequence.

At the outset we should state that we fully support the underlying intent of the change in control provisions, namely that a change in control of a title holder should be subject to approval in the same way as a transfer of an interest in a title. However, the Bill as drafted will likely be over-inclusive in its reach as well as leading to what might regarded as technical breaches that do not offend the spirit or policy intent of the Bill.

If nothing else, we strongly recommend that some facility for the making of regulations to provide for exceptions, or some other power to grant exemptions on a class basis, is included in the Bill before it is passed.

1. Problems with the change in control provisions

566B Meaning of control and change in control of registered holder

*(1) A person **controls** the registered holder of a title if the person (whether alone or together with one or more other persons the person acts jointly with):*

(a) holds the power to exercise, or control the exercise of, 20% or more of the voting rights in the registered holder; or

(b) holds, or holds an interest in, 20% or more of the issued securities in the registered holder.

*(2) A person **acts jointly with** another person if the person acts or is accustomed to acting in agreement with, or in accordance with the wishes of, the other person.*

(3) The regulations may prescribe a different percentage, or different percentages, to the percentage specified in paragraph (1)(a) or (b).

*(4) There is a **change in control** of a registered holder of a title if:*

*(a) one or more persons (an **original controller**) control the registered holder of a title at a particular time; and*

(b) either:

(i)one or more other persons begin to control the registered holder (whether alone or together with one or more other persons the person acts jointly with) after that time; or

(ii)an original controller (whether alone or together with one or more other persons the person acts jointly with) ceases to control the registered holder after that time.

What this means:

A person who holds or controls shares in the holder of any offshore petroleum title will be in breach of the Act (as amended by the Bill) if:

- they acquire more than 20% of the title holder or a holding company, even if that does not confer actual effective control;
- their holding goes over 20% due to a buy back or capital reduction (that is, they don't actually do anything);
- their holding goes over 20% if they take up their share under a pro rata rights offer but not all the other shareholders take up their shares (and the holder won't know this at the time of making the decision to take up their pro rata shares);
- their holding if above 20% goes under 20% even if involuntarily, for example a 21% holder is diluted because they did not take up their pro rata share in a rights offer or the company does a placement or a convertible security is converted and the holder is simply diluted

The above example will also apply to a holding in a company that holds more than 20% of a title holder. And a company that holds more than 20% of a company that holds more than 20% of a title holder. And so on.

Why this is a problem:

The control threshold in the Bill is triggered at 20%. This is the threshold for Chapter 6 of the Corporations Act (**CA**) and Foreign Acquisitions and Takeovers Act (**FATA**) but there are different policy underpinnings for those pieces of legislation.[1]

[1] Under the Corporations Act, 20% is the bright line test under which it is accept that control cannot be exercised, and to acquire more than 20% one of the exempted methods of acquisition must be followed. In the UK, the City Code uses a 30% threshold to trigger a "follow on bid" so that anyone acquiring over 30% must make an offer for the balance. The 30% threshold is based on the view that 30% is the test for effective control in a widely held company, but noting that there is no prohibition, just a trigger. The policy drivers for FATA are different again

It is possible that a person will have effective control at 20.01% but in practice, with a public company, this is not likely, especially if there are other larger holders.[2]

The CA and FATA thresholds are prophylactic and the CA does not prohibit acquisitions above 20% but simply regulates the procedures by which they must by undertaken. Indeed the CA contains many exceptions such as rights issues, the 3% creep, takeover bids. The FATA has an exception for rights issues.

Neither the CA nor FATA regulate cessation of control.

We also observe that setting the threshold at 20% may actually be **under-inclusive** because the change of control at 20% may not be actual, but the authority will need to exercise its discretion having regard to the circumstances at that time. If the person in question then moves to take actual control, no further discretion with remain to be exercised.

The Bill's control threshold should not be set at 20%, but rather use a concept of effective control, and have a deeming provision that over 50% of the votes or the practical ability to appoint a majority of the board members of the titleholder is deemed to be effective control. If the Bill's objective is to treat transfer of interest in a titleholder or a company with effective control of a titleholder in the same way as the transfer of a title, the Bill should seek to do that directly.

The Bill does not contain any exceptions or the mechanism to create exceptions. The CA has a regulation making power and an exemption and modification power conferred on ASIC that has been used to grant both specific and class relief under Chapter 6 of the CA. The FATA has a regulation making power.

Just by way of example, a purely internal restructure of a multinational group that holds offshore titles in Australia taking place entirely offshore to insert a new intermediate holding company would require approval. This is nonsensical where there is no change in substance.

Also, it will simply not be practical to obtain approval for a shareholder in an ASX listed company who goes over or drops under 20% because of a rights offer made to all shareholders. Institutional shareholders have a matter of hours or a best days to decide whether to accept their entitlement in an accelerated rights offer. There is simply no way an approval could be obtained in these circumstances.

This may present a major impediment to publicly listed direct or indirect title holders raising capital if they have major shareholders at around 20%.

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and the 20% threshold deliberately captures many acquisitions that in no sense confer actual or effective control. Indeed, in some cases a lower threshold triggers FATA's application when coupled with other features such as the right to appoint a director.

[2] 20% will only generally confer effective control if the balance of the shares are very widely held. We acknowledge that the Department wishes to regulate direct holders of shares in titleholder who may have less than 50%, for example in a titleholder that was a joint venture company. However, this is actually a different objective to seeking to regulate changes of control, because (for example) if three shareholders each held 33.3% of the shares none of them would have control of the titleholder as that concept is commonly understood. And that may be a worthy objective, but it does not, in our submission, justify regulating all indirect holders of more than 20% no matter

And it would be inequitable that a major shareholder sitting at just above 20% who simply deciles not to take up an entitlement because they thought it was not a good investment could be subject to a penalty.[3]

The Bill should be amended to contain or contemplate exceptions.

The Bill uses bespoke concepts that do not reflect either the CA or FATA. This creates a further regulatory regime that must be navigated by titleholders, acquirers and their advisers, but does not, in our submission, reflect any sound policy rationale.

The Bill should be amended to reflect the CA concepts of "voting power", "relevant interest" and "associate" so that the regulatory regime is simpler and more consistent with the CA Regimes.

The Bill (at clause 566Z) has an infinite interest tracing provision at a 20% threshold. That is, interests can be traced up a chain of ownership if equity interests of 20% or more are held. Such tracing can occur an unlimited number of times.

This is likely to be unworkable in practice and result in unintended and inconvenient consequences. While it is possible (although unlikely) that a direct 20.01% interest will confer effective control, the acquisition of an indirect 0.8% economic interest constituted by a 20% holding in company A that has a 20% holding in company B that has a 20% interest in a title holder would trigger the requirement for a change in control approval.

While it is true that control can be exercised through chains of ownership, the CA only allows the 20% deemed control rule to be used once (see section 608(3)).

An unlimited tracing rule would make sense if it was set at the effective control level, as is the case for section 608(3)(b) of the CA – which enables infinite tracing where there is actual or effective control.

The Bill's tracing provision appears to be based on the FATA provisions (section 19 of FATA) but at least section 19 of FATA has an exception in section 19(3) that has important practical effect. Moreover, FATA has a number of practically important exceptions, for example for money lending agreements (the exercise of security could readily cause an acquisition of control by a secured creditor under the Bill), foreign custodians who hold merely legal title to securities, for rights issues, and DRPs. Or the appointment of a liquidator or administrator to an insolvent company that holds an interest in an offshore title would seem to involve the acquisition of control.[4]

The Bill has none of these exceptions, and no facility for introducing them.

But more importantly, the policy foundations of FATA and the Bill are quite different. The approach in FATA needs to be more precautionary and setting a threshold at 20% and having extensive tracing rules makes more sense for matters involving the national interest, including national security. But the policy drivers for approval of changes of control of

[3] The qualification in clause 566N(4) of the Bill concerning knowledge does not necessarily assist because the shareholder will become aware that they have ceased to control or begun to control because that consequence of their action or inaction may well be evident. Moreover, and unfairly, the defendant will bear an onus of proof to show their innocence.

[4] This might result in the unfortunate consequence that an administrator or liquidator might refuse to be appointed because they would immediately be in breach of the Act as amended by the Bill, with no means of overcoming that consequence.

titleholders are, in our submission, more limited and should be centred around financial capacity and proper governance – matters that will not likely to be affected by a 21% holder in a chain of holdings.

Moreover, the policy about approval for ceasing to have control is quite different and setting the threshold at 20% with infinite tracing provisions will certainly catch transactions that have no relevance to the policy objectives underlying the Bill, being primarily financial capacity or assurance and governance.

The Bill will impose compliance costs and impediments to economically sensible and beneficial transactions with no policy benefit.

The Bill should be amended so that the tracing provisions operate in a proportionate manner, and are based on effective control.

2. Problems with the revocation of approval provisions

566J Revocation of approval

Revocation

(1) The Titles Administrator may revoke an approval of a change in control of a registered holder of a title in the approval period for the change in control if:

(a) there is a change in the circumstances of a person who is approved to:

(i) begin to control the registered holder; or

(ii) cease to control the registered holder; and

(b) the Titles Administrator considers it appropriate to revoke the approval.

Notice of revocation

(2) If the Titles Administrator revokes an approval of a change in control, the Titles Administrator must give written notice of the revocation to the person given notice of the approval of the change in control.

What this means:

A person who has been approved for a change in control can have that approval revoked if there is a change in circumstances. This can occur during the approval period but after the change of control has occurred or after a person is legally committed to effect a change in control.

Why this is a problem:

Such a revocation could be made after the event, or when a person is fully committed to acquiring shares under a takeover or scheme of arrangement or private treaty acquisition.

This is inherently unfair and, in our submission, offends basic rule of law principles.[5]

[5] Clause 566T of the Bill also precludes reliance on the privilege against self-incrimination in the context of the investigation powers to be conferred by the Bill. This is also offensive to basic rule of law and human rights principles.

Transactions cannot be practically structured so that they do not complete until the last moment of the approval period.

The Bill should be amended so that an approval cannot be revoked once it has been relied upon or a person is legally committed to implement the change in control transaction in reliance on an approval.

Conclusion and further contact

The BLS would be pleased to discuss any aspect of this submission.

Please contact John Keeves, a member of the BLS Executive at john.keeves@jws.com.au or on 0419 039 019 if you would like to do so.

Yours faithfully

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Chair, Business Law Section