



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 47

# **Associates: Share acquisition agreements**

November 2003

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### **Your comments**

**You are invited to comment on the proposals and issues for consideration in this paper, including the explanation sections. All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential.**

**Comments are due by Friday 6 February 2004 and should be sent to:**

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**You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.**

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# What this policy proposal is about

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**1** This policy proposal paper explains proposed case-by-case relief from the “associate” definition for the purposes of the takeover, compulsory acquisition and substantial holding provisions of the Corporations Act: s12. Under our proposed relief, parties to a relevant agreement relating to acquisition and disposal of securities (“acquisition agreement”) are not associates merely because of the acquisition agreement. An example of an acquisition agreement is an option. We propose to give this relief because the scope of the associate definition as extended by reg 1.0.18 and s53 is unclear.

**2** After we receive your comments, we propose to amend Policy Statement 171 *Anomalies and issues in the takeover provisions* [PS 171] to include this issue.

**Important note:** The proposals, explanations and examples in this paper do not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act applies to you. It is your responsibility to determine your obligations under the Corporations Act and regulations. The proposals, explanations and examples in this paper are at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Examples in this paper are purely illustrative; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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# Our policy proposal — issues for consideration

Policy proposal	Your feedback
<p><b>1</b> We propose to give case-by-case relief from the definition of associate: s12. Under our relief parties to an acquisition agreement would not be associates merely because under the agreement one party has the right to acquire securities from or dispose of securities to the other. For examples of acquisition agreements see policy proposal paragraph 13.</p> <p><b>2</b> We propose to give this relief because the scope of the associate definition as extended by reg 1.0.18 and s53 is unclear. The proposed relief would be from the following limbs of the associate definition:</p> <p>(a) parties to a relevant agreement for the purpose of controlling or influencing the conduct of the affairs of a body are associates—section 12(2)(b); and</p> <p>(b) parties acting in concert in relation to the affairs of a body are associates—section 12(2)(c).</p>	<p><b>1A</b> Is our proposed relief too narrow or too wide? In particular, is there any agreement within our proposed relief that should fall outside it?</p> <p><b>1B</b> Should we give class order relief instead of case-by-case relief? Should we give class order relief for a narrower range of acquisition agreements eg:</p> <p>(a) an on-market transaction—s9;</p> <p>(b) equity derivatives entered into on a financial market; or</p> <p>(c) off-market cash sale agreements with short settlement periods?</p> <p>We would give case-by-case relief for other types of acquisition agreements: see policy proposal paragraph 13.</p> <p><b>1C</b> Instead, should we give relief so that parties are not associates merely because of provisions in an agreement concerning acquisition or disposal? This would mean that if other provisions in the same agreement gave rise to an association, our relief would not apply.</p> <p><b>1D</b> Should we instead give relief from s610 only? This would limit relief to references to "voting power" eg s606 (main takeover prohibition) or s640 (expert's report if bidder has 30%</p>

**Policy proposal****Your feedback****What is the effect of relief?**

- 3** An important effect of our proposed relief is that a party to an acquisition agreement will not have voting power reflecting the securities of the other party that are not covered by the acquisition agreement: s610.

**What are the requirements for relief?**

- 4** We would give the proposed relief only where the following preconditions were met:
- (a) the parties to the acquisition agreement do not have a “control purpose” (see policy proposal paragraphs 6-11); and

voting power in target). Instead should we give relief from s606 only? Relief limited to s606 or 610 would mean the parties to an acquisition agreement may be associates for other purposes eg s623 (collateral benefits offered by an associate)?

- 1E** As well as applying to the takeovers provisions in Chapter 6 of the Act, do you agree that our relief should apply to:
- (a) the compulsory acquisition provisions in Chapter 6A; and
  - (b) the substantial holding provisions in Chapter 6C?
- 1F** Do you think it would be more appropriate to deal with this issue by a law reform process?

- 4A** Would our requirement that the acquisition agreement sets out all the terms that contributed to the acquisition be too restrictive in practice? Why?

Policy proposal	Your feedback
<p>(b) the acquisition agreement is in writing and sets out all the terms that contributed to the acquisition and disposal. This is similar to the requirement in s671B(4).</p> <p>5 These requirements would also be reflected in the terms of any relief instrument that we may make.</p>	
<p><b>What is a control purpose?</b></p>	
<p>6 For the purposes of our proposed relief, there will be a control purpose where:</p> <p>(a) the terms of the acquisition agreement suggest that the parties to the acquisition agreement have a common purpose of controlling or influencing:</p> <p>(i) the composition of a body's board; or</p> <p>(ii) the outcome of decisions about the body's financial and operating policies; or</p> <p>(b) other circumstances suggest that the parties may have a control purpose.</p>	<p>6A Is there another way of distinguishing acquisition agreements that should create an association from those that should not?</p> <p>6B Is there more appropriate language to describe control over a company than that in policy proposal paragraph 6(a)(ii), borrowed from control s50AA (in turn adapted from accounting standards on consolidated accounts) and relevant interests through group entities s608(4)?</p>
<p>7 If the parties breached the terms of the proposed relief because they in fact had a control purpose, we or another party could apply to the Takeovers Panel for a declaration of unacceptable circumstances or we could take other regulatory action.</p>	
<p><b>Examples of control purpose</b></p>	
<p>8 Examples of circumstances that suggest a control purpose so that we would <i>not</i> give relief are where the acquisition agreement states or other evidence suggests the parties have an agreement,</p>	<p>8A Are there any other useful examples of circumstances where we should refuse relief?</p>





Policy proposal	Your feedback
<p>(b) a material trading relationship; or</p> <p>(c) a trustee and a beneficiary of the trust; or</p> <p>(d) parties having common directors.</p> <p><b>11</b> In any event our proposed relief would apply only to associations created <i>merely</i> because of the acquisition agreement. The relief would not apply where the parties were in the same corporate group (s12(2)(a)) or were otherwise acting in concert in relation to the affairs of the body.</p>	
<p><b>What is an acquisition agreement?</b></p> <p><b>12</b> For the purposes of our proposed relief, an “acquisition agreement” is a relevant agreement concerning acquisition or disposal of securities. An acquisition agreement may be conditional or enforceable in the future.</p>	<p><b>12A</b> Should our relief be limited to acquisition agreements? What other agreements should attract our relief?</p>
<p><b>Examples of acquisition agreements</b></p> <p><b>13</b> Examples of acquisition agreements are:</p> <p>(a) an on or off-market sale agreement;</p> <p>(b) an equity derivative, whether entered into or acquired on a financial market or off-market;</p> <p>(c) a pre-acceptance agreement (ie an agreement where a bidder agrees with a holder that the holder will accept the bidder’s offer under a bid);</p> <p>(d) a pre-emptive right or right of first refusal.</p>	<p><b>13A</b> Are there any other useful or common examples of acquisition agreements?</p> <p><b>13B</b> Should we treat different acquisition agreements differently? If so, on what basis?</p> <p><b>13C</b> In the case of a pre-acceptance agreement, should we require the agreement to expire if the bidder has not announced a bid within 3 months of the parties entering into the agreement?</p>

# Explanation

## What is the rationale for relief?

**1** The concept of “associate” in s12 groups together persons whose interests in control over a company are aligned. It ensures that a person is not treated as acting independently from a person with whom they are in fact cooperating. The concept ensures that eg:

- (a) persons who collectively acquire securities cannot avoid the 20% takeover prohibition—s602(c), 606 and 610. All shares held by associates are treated as a single block; and
- (b) an associate of the bidder cannot offer a collateral benefit that the bidder would be prohibited from offering—s623; and
- (c) an associate of the bidder or target cannot be an independent expert, because this role requires the exercise of independent professional judgement—s648A(2).

**2** An acquisition agreement should not create an association between the person who may acquire securities under the agreement (“buyer”) and seller, unless they have a common purpose of controlling or influencing control of a company.

**3** The seller is not seeking control of the company together with the acquirer, but merely disposing of their securities. The Act recognises that the buyer obtains rights over the securities the subject of the acquisition agreement because they get a relevant interest in the securities: s608. It is not appropriate that securities held by the seller outside the acquisition agreement are counted with the buyer’s securities.

## Who is an “associate”?

**4** An associate includes someone with whom:

- (a) the person has a relevant agreement for the purpose of controlling or influencing the composition of a designated body’s board or the conduct of the designated body’s affairs—s12(2)(b); and
- (b) the person is acting, or proposing to act, in concert in relation to the designated body’s affairs—s12(2)(c).

**5** Paragraphs 12(2)(b) and (c) have an extended meaning given by s53. The scope of the extended definition is unclear.

## Extended meaning of “associate”

**6** The definition of “affairs of a body corporate” in s53 applies to references to “designated body’s affairs” in s12(2)(b) and (c): reg 1.0.18. Section 53 is very broad.

**7** Section 53 was originally intended to apply in the insolvency context to the definition of “examinable affairs”. Some of its paragraphs are difficult to apply in the associate context eg “matters concerned with the ascertainment of the persons who are...financially interested in the success or failure...of the body”: s53(g).

**8** Other paragraphs are easier to read in the associate context. For example, by reading s12(2)(b) and 53 together, an acquisition agreement may create an association because it may be an agreement for the purposes of controlling the conduct of either:

- (a) the ownership of shares—s53(e); or
- (b) the power of persons to dispose of or exercise control over the disposal of shares—s53(f).

**9** However, the legislative history of the associate definition suggests that this meaning of associate encompassing all agreements concerning ownership and disposal of shares may be wider than Parliament intended.

## Why is relief appropriate?

### *Legislative history*

**10** If an acquisition agreement creates an association, an important effect is that each party gets voting power reflecting all securities in which the other party has a relevant interest: s610.

**11** This was a problem under the Companies (Acquisition of Shares) Code: see s7(4)(b)(iii) and (iv) and 7(4)(f). The Corporations Law rectified this problem: see the definition of “entitlement” in s609(1)(b) and (2) of the pre-CLERP Act Law. The Explanatory Memorandum to the Corporations Bill para 1908 stated:

“any shares held by an associate of a person (the association arising by virtue of an agreement by the person to acquire particular shares from the other person) which are not subject to the agreement will not be included in the person’s entitlement (sub-cl 609(2)).”

**12** The Report of the Joint Select Committee on Corporations Legislation stated that under the Corporations Bill:

“13.5 The concept of entitlement is retained with the qualification that where an association arises by virtue of an agreement by one person to

acquire particular shares from another person, the association will be regarded as existing only in relation to those shares.”

**13** The then Attorney-General stated:

“The amendments narrow the range of an associate’s relevant interests to be included in a person’s entitlement to shares for the purposes of cl 609. Clause 609(2) was specifically drafted to rectify an anomaly in the equivalent cooperative scheme provisions in relation to acquisition agreements by limiting the entitlement to only those shares the subject of the agreement”: House of Representatives *Hansard*, 28 September 1988, at 1110.

**14** The Legal Committee of the Companies and Securities Advisory Committee (now CAMAC) in its Report *Anomalies in the takeovers provisions of the Corporations Law* (1994) agreed with the policy of ensuring “that a person who is an associate of another only by virtue of an agreement relating to particular shares has an interest in those shares only, not all shares held by the associate”.

### ***Ordinary meaning of s12***

**15** The ordinary meaning of the references to the composition of the board and controlling or influencing the conduct of, or acting in concert in relation to, a body’s affairs in s12(b) and (c) suggests that these provisions were intended to apply only where the parties have a control purpose.

### **Relevant interest**

**16** Under our proposed relief, the buyer would still have voting power that reflects securities covered by the acquisition agreement. The buyer gets a relevant interest in these securities because they have the power to control the exercise of a power to dispose of the securities: s608(1)(c). The relevant interest concept includes power or control by means of an agreement and subject to restraint or restriction: s608(1)(b) or (c). Under s608(8), if one party has a relevant interest, they give a relevant interest to the party as soon as they:

- (a) enter into an agreement with respect to the securities; or
- (b) give or have been given a right in relation to the securities, enforceable presently or in the future and whether or not on the fulfilment of a condition; or
- (c) grant an option to, or have been granted an option by, another person.

Section 608(8) applies for example to a put or call option.

## ***Voting agreement***

**17** If the parties have an agreement about voting, we would not give associate relief because this suggests a control purpose: see policy proposal paragraphs 6-8. In any event, an agreement eg that the parties must support each other in voting would give each party a relevant interest in the securities of the other. This is because the agreement would give the parties power to control the exercise of a right to vote attached to the securities: s608(1)(b).

## **Purpose of influencing body's policies**

**18** Under our proposal, we will *not* give relief if a purpose of the acquisition agreement is to control or influence the outcome of decisions about the body's financial and operating policies: policy proposal paragraph 6(a)(ii). This test is borrowed from:

- (a) the definition of "control" in s50AA (in turn adapted from AASB 1024 "Consolidated Accounts") used in eg:
  - (i) Takeovers Panel powers—the Takeovers Panel can make a declaration if it appears that circumstances are unacceptable having regard to the control, or potential control, of the company—s657A; and
  - (ii) related party transactions—financial benefit given by entity that the company controls (s208); and
- (b) relevant interests through group entities (s608(4)).

We consider this test is consistent with the ordinary meaning of the language in s12(2)(b) and (c) of controlling or influencing the conduct of, or acting in concert in relation to, a body's affairs.

**19** For policy proposal paragraph 6(a)(ii) to apply, it is not necessary that the parties actually control the body. The parties need only have either:

- (a) a common *purpose* of controlling the body's policies rather than actually controlling the policies; or
- (b) a common purpose of *influencing*, rather than controlling, the body's policies.

## **Between buyers and sellers only**

**20** We would give relief for associations between buyers and sellers only. Our relief would not cover eg an association that may arise between two or more buyers who approach a holder together to acquire securities: *Re Walker and Kahlua Pty Ltd* (1996) 22 ACSR 104, 107.

## How to apply for relief

**21** Under our proposed policy, an applicant for relief would have to:

- (a) give us a copy of the acquisition agreement; and
- (b) set out a full explanation of the circumstances of the acquisition agreement, such as any:
  - (i) wider transaction; or
  - (ii) pre-existing or wider relationship between the parties.

# Development of policy proposal

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We have developed this policy proposal paper in light of our experience of applications received by us and issues raised in relation to the "associate" definition since the introduction of the CLERP Act in March 2000. We have also considered:

- (a) Explanatory Memoranda, draft Bills and speeches for the Corporations Act, CLERP Act and Financial Services Reform Act 2001 and Companies (Acquisition of Shares) Code
- (b) Corporate Law Economic Reform Program Proposals for Reform: Paper No. 4 *Takeovers. Corporate control: a better environment for productive investment* (1997)
- (c) Legal Committee of the Companies and Securities Advisory Committee *Anomalies in the takeovers provisions of the Corporations Law Report* (1994)
- (d) Simplification Task Force *Takeovers: Proposal for Simplification* (1996)
- (e) ASIC Policy Statement 128 *Collective action by institutional investors*; Policy Statement 171 *Anomalies and issues in the takeover provisions*
- (f) NCSC Policy Statement 105 *Companies (Acquisition of Shares Code): discretions vested in the Commission*; NCSC Policy Statement 134 *Companies (Acquisition of Shares Code): associations arising as a result of options trading*
- (g) the following Takeovers Panel and court decisions:
  - Re Aliquot Asset Management Ltd* (Unreported, Takeovers Panel, 16 May 2003)
  - Re Anzoil NL* (Unreported, Takeovers Panel, 24 December 2002)
  - Flinders Diamonds Ltd v Tiger International Resources Inc* (2003) 45 ACSR 575
  - Re Edensor Nominees Pty Ltd v Australian Securities & Investments Commission* [2002] FCA 307
  - Re Elders IXL Ltd* (1986) 10 ACLR 719
  - Re Namakwa Diamond Company NL (No 1)* (Unreported, Takeovers Panel, 30 May 2001)
  - Re Online Advantage Ltd* (Unreported, Takeovers Panel, 10 September 2002)
  - TNT Australia Pty Ltd v Poseidon Ltd* (1989) 15 ACLR 80

*Trustee for the Estate of the Late AW Furse No 5 Will Trust v  
Federal Commissioner of Taxation* (1990) 21 ATR 1123, 1132.  
*Re Trysoft Corporation Ltd* (Unreported, Takeovers Panel, 23  
September 2003)  
*Re Walker and Kahlua Pty Ltd* (1996) 22 ACSR 104  
*Re Winepros Ltd* (2002) 43 ACSR 566

- (h) comments provided by the Takeovers Panel in response to informal consultation.



# Key terms

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In this policy proposal, a reference to:

“acquisition agreement” means a relevant agreement relating to acquisition and disposal of securities

“Act” means the *Corporations Act 2001*

“buyer” means a person who may acquire securities under an acquisition agreement

“CLERP Act” means the *Corporate Law Economic Reform Program Act 1999*

“s606” (for example) means a section of the Act

“seller” means a person who may dispose of securities under an acquisition agreement.

Some expressions used in this policy proposal paper are defined in the Act.

# What will happen next?

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## Stage 1

25 November 2003                      ASIC policy proposal paper released

## Stage 2

6 February 2004                      Comments due on the policy proposal

February 2004–April 2004      Drafting amendment to PS 171

## Stage 3

April 2004                              Amended PS 171 released

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### Your comments

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