In addition the Committee is considering recent governmental proposals affecting the structuring of banks and financial institutions, in particular the further statement of 9th April on the availability of interest withholding tax exemptions for Offshore Banking Units and the 30th April statement proposing amendments to the Income Tax Assessment Act restricting deductibility of interest payable by "thinly capitalised" financial and other institutions having substantial foreign shareholdings. The Committee has noted the Treasurer's 19th May announcement foreshadowing amendments to the Banking Act to give the Reserve Bank legislative backing for its role in the supervision of banks, and has requested the opportunity to comment on the proposed legislation. The Committee is also preparing a comparative survey of the regimes for banking supervision, prudential requirements and cost in terms of local taxation, applicable to international financing transactions entered into in New York, Hong Kong and Australia with a view to facilitating the implementation of such transactions in this country.

4. Stamp duty

The Sydney members of the Committee made submissions concerning the recent amendments to the New South Wales Stamp Duties Act. In particular they expressed concern that the new Section 44G of the Act, imposing on legal advisers the obligation to assist in revenue collection will be in clear conflict with the duty of confidence, and other duties, owed by them to their clients.

Banking Law and Consumer Credit Committee

The Vesting of Shares in the National Companies and Securities Commission

Introduction

The following summarises a submission made by the Law Council on the above topic. The submission was prepared by the Banking, Finance and Consumer Credit Committee and reviewed by the Companies and Securities Committee before its despatch. The matters, the subject of the submission are under consideration by the National Companies and Securities Commission and Securities Law Review Committee. The NCSC has stated that the submission covers a number of matters and considerable importance which have exercised its attention in the past.

The national companies and securities legislation in four places empowers a court to make an order "vesting in the Commission shares or any interest in shares" — sections 146(1)(ea) and 261A(2)(e) of the Companies Act and Codes (the "Code") and sections 45(1)(da) and 60(4)(b)(v) of the Companies (Acquisition of Shares) Act and Codes (the "Takeover Code"). These sections relate, respectively, to the substantial shareholding provisions, section 261 notices, prohibited acquisitions and unacceptable conduct.

Only one such vesting order, under section 261A, has actually been made, and it was set aside on appeal (in *Re North Broken Hill Holdings Ltd.* (1986) 4 ACLC 181). The possibility of orders has, however, arisen in many other large takeover battles, including those for BHP and Humes, in connection with very valuable shareholdings.

A feature of recent Australian contested takeovers has been the large amount of bank credit, usually secured on shares to be acquired, extended to offerors. The effect of vesting orders on the security interest of lenders in vested shares is not specifically addressed by the legislation and has led to considerable doubt as to secured lenders' rights. The submission identifies the problem areas and advances policy recommendations.

The fundamental approach of the submission is that vesting orders should be analysed as instruments for the enforcement of relevant statutory obligations rather than the achievement of other policies relating to takeovers.

The vesting mechanism raises problems other than those which strictly concern lenders' securities. The submission does not analyse them but identifies some for concurrent review by interested authorities. They include questions as to the consequences of vesting on registration, voting rights, dividend and accretion rights and on-sales.

The Problems for the Secured Lender

The submission identifies five principal problems. These are:

1. Can a vesting order be made, notwithstanding a lender's security interest?
2. If a vesting order is made, what are the respective priorities of the NCSC and any secured lender?
3. Can a secured lender enforce its security rights, notwithstanding the vesting order?
4. Can a secured lender exercise any control over the manner and timing of the exercise by the NCSC of its power of sale?

5. Is a secured lender entitled to a share in the proceeds of any sale of the shares by the NCSC?

In the Humes settlement, a large "fine" was paid out of the proceeds of sale of the disputed shares. Although this settlement did not involve any apparent security interests, the possibility exists that the Crown, in imposing similar fines, may seek to have its position elevated to that of a secured creditor by means of vesting orders. It may therefore be that the Crown (rather than the NCSC) would be the competing party.

The Current Position

Vesting orders are discretionary. However, orders made under each of the four vesting powers may not "unfairly prejudice" any person — sections 146(6) and 261A(8) of the Code and section 49 of the Takeover Code. The onus of proving unfair prejudice would seem to lie on the party asserting such prejudice, at least in relation to section 261A of the Code and section 49 of the Takeover Code — see *North Broken Hill; Gjergia & Atco Controls Pty. Ltd. v. Cooper* (1986) 4 ACLC 359. The position under section 146(6) of the Code is unlikely to be different.

Although it was originally suggested that any prejudice to an innocent party would constitute "unfair" prejudice *(Corporate Affairs Commission (S.A.) v. Orlit Holdings Ltd.* (1983) 1 ACLC 1038), it seems that the better view now is that mere innocence will not protect an outsider — *Gjergia.* According to the majority of the Victorian Full Court in *Gjergia,* it is necessary to look to "the justice and equity of the whole case" — McGarvie J. at 362-3, Ormiston J. at 373. The innocence of a lender/mortgagee will therefore not necessarily preclude the making of a vesting order.

The critical question governing the priority relationship of a secured lender and the NCSC is whether vesting orders extinguish prior security interests.

Notwithstanding the general rule of construction that legislation is not intended to extinguish proprietary right without clear words, the vesting powers can be interpreted to permit vesting of shares in the NCSC free of security interests. Section 146(1)(ea), which refers to the vesting of "shares ... to which the substantial holder ... has been entitled", clearly contemplates an order being made in respect of shares to which the defaulting substantial shareholder is no longer entitled. Accordingly, it must also contemplate (if the word "vest" and the order itself are to have any significance) the acquisition or extinguishing of some other proprietary interest. A similar analysis can apply in relation to the other sections, each of which draws the distinction between "the shares" and "any interest in the shares".

It is necessary also to consider section 463 of the Code, which provides that:

> Property vested in the Commission ... is liable and subject to all charges, claims and liabilities imposed on or affecting that property by reason of any law as to rates, taxes, charges or any other matter or thing to which the property would have been liable or subject had the property continued in the possession, ownership or occupation of the company.

Section 463 is linked to the operation of the statutory vesting powers through sections 146(12)(c) and 261A(15)(c) of the Code and section 49(6)(c) of the Takeover Code.

Section 463, which was originally inserted in the Code to deal with dissolved companies which still owned assets, operates in relation to property by reference to "the company". Clearly, this reference should, in the context of vesting orders, be deemed to be to someone else, but whom? This requires recognition that vesting orders must be directed "at" a person with an interest in shares and equally some recognition of the presence of "innocent" parties with an interest in the shares. This in turn places a great burden on the Court hearing an application for a vesting order — to determine, with no statutory guidance, who is to be regarded as "innocent" and thus protected by section 468. Furthermore, the section suffers from ambiguity. Should "any other matter or thing" be read ejusdem generis with "rates, taxes and charges" so as to limit the section to government or semi-government charges?

Accordingly, it is arguable that a Court has the power to vest shares in the NCSC free of the proprietary interests of secured lenders. Whether any particular order does in fact have that effect will be a question of the construction of the order. Few orders will be sufficiently clear to resolve this question.

As to the second issue, that of priorities, a conventional dispute between a secured lender and the NCSC requiring the application of equitable principles would presumably arise where it was clear that no extinguishment of the security interest occurred. It would be unfortunate for the respective rights of the parties in situations such as this to be governed by technicalities.

The third question, that of control over the sale of the shares by the NCSC, depends on the priority analysis, although the Court may of course give directions as to any sale. The question is one of basic importance because the NCSC and the lender may have very different realisation objectives.

Even if the secured lender could itself exercise a power of sale, the marketability of shares might be dramatically reduced by any possibility that the shares were, or were liable to be, vested in the NCSC.

The final question, whether a secured lender is entitled to share in the proceeds of sale by the NCSC, depends again on the priority position. It is not clear that a secured lender may participate in the proceeds of sale. In addition, whatever be the priority position, it is apparent from the Humes settlement that the Crown may look to sale proceeds to pay NCSC costs and, possibly, fines, in priority to other interests.

Appropriate Policy

The following propositions were advanced as appropriate:

Certainty is desirable. Enforcement mechanisms operating in respect of proprietary rights must be clear. A more certain vesting order regime may in fact prompt greater use of the mechanism by the NCSC (which must, at present, be reluctant to do so given its uncertainties) for proper enforcement purposes.

Vesting orders should not be used to punish. First, it is unfair for punishment to depend upon the "fortuitous" circumstances that the wrongdoer is holding shares at the time of his punishment. Secondly, there are already ample penalty provisions (sections 144, 261(14) and 53) under which substantial fines can be imposed.

Vesting order ought, rather, to be seen as serving two functions. First, to enable courts to "freeze" shares, in order to permit the NCSC and the company to determine the true position regarding some aspect (e.g. beneficial ownership) of the shares. Section 146 and 261A should be seen in this light, as would the use of vesting orders in Humes-type situations. Secondly, such orders should permit the undoing of unlawful transactions. Offences under sections 45 and 60 would warrant this approach.

Some may argue that financiers help offerors to avoid their statutory duties by, for example, collaborating in the establishment of "warehousing" structures. True or not, this does not justify subjecting financiers to multi-million dollar penalites. It would be more logical for the legislation explicitly to punish all accomplices or associates (which could include errant financiers) by subjecting them to the same penalties as principal offenders. It is equally inappropriate for vesting orders to be used expressly to punish statutory breaches by offerors.

Vesting order powers should not be used to achieve broader regulatory objectives. It is clear, for example, that lenders, who may have no control over the acquisitions for which their money is used, may be more concerned about takeover financing simply because vesting orders are a theoretical possibility. This is magnified by the threat of section 60 declarations, which may expose otherwise completely lawful acquisitions to a risk of divestiture in favour of the NCSC. It would be inappropriate for a policy aimed at reducing leverage in takeovers to rely on the dampening effect of uncertain vesting powers.

General Recommendations

The following general recommendations for reform were made in the submission:

1. In all circumstances, a secured lender's interest must survive a vesting order. Anything else may constitute a direct transfer of money from the lender to consolidated revenue and would be an unacceptable punishment in the absence of a prior successful prosecution of the lender.

2. A secured lender must be entitled to participate in the proceeds of any sale by the NCSC in priority to the consolidated revenue, or anyone else. This entitlement must be independent of any discretion on the part of a Court or Minister and of any perceived "guilt" on the part of the lender (subject perhaps to a right to set off any fine specifically imposed on the lender). Anything else would inject too high a level of uncertainty into takeover financing.

3. A secured lender must have a right to sell, or some control over the sale process. The desirable level of control will be difficult to fix, as there will be competing interests at stake. These are

(a) on the part of the lender, ensuring a rapid, profitable realisation of its security; and
(b) on the part of the NCSC, ensuring that a controlling share block is dispersed rapidly and widely, with minimal disruption to the share price.

4. The NCSC should, in relation to sales, have some accountability both to the former owner and the secured lender, to ensure that reasonable efforts are made to realise the shares for the best available price.

Specific Recommendations

The following specific proposals were suggested by way of statutory reform:

1. The Court should be obliged, when making a vesting order, to nominate the person whose interest is being vested or specify the interest it is vesting in the NCSC.

2. If the Court vests the interest of a nominated person in the NCSC, the NCSC should hold that person's interest subject to all other interests to which that person would have been subject had he still held the interest.

3. If the Court vests a specified interest in the shares in the NCSC (e.g. the beneficial interest in the shares), the NCSC should (subject to its power of sale) hold that interest for those persons who, together, held that interest prior to the vesting order being made. The rights of those persons, inter se, should remain unchanged by the vesting order.

4. If the Court vests the interest of a nominated person in the NCSC, a secured lender would (by virtue of 2 above) be entitled to compel and control the sale. A lender-controlled sale should be subject to the supervision of the NCSC, such supervision to be supported, if necessary, by the Court (on application by the NCSC) having regard to stated criteria.

5. If the Court vests a specified interest in the NCSC, the NCSC would control the sale. Such a sale would again be subject to judicial supervision in accordance with the stated criteria.

6. Proceeds of sale should be held by the NCSC in accordance with 2 and 3 above. That money should be held on a limited trust (subject to stated powers, duties and time limits) prior to remittance to the appropriate parties (whether secured lender, shareholder or consolidated revenue).

7. Some form of "proof of debt" mechanism should be established to determine claims against any fund held by the NCSC.

8. The link between sections 462 and 463 of the Code and the vesting orders should be broken.

9. It should be made clear that the Court is obliged to accord all persons with an interest in the share the right to make submissions on the appropriate order.

John Harry and Richard Hall

Trade Practices Committee — Report

Liability for Misrepresentation in Business Transactions — Entire Agreement Clauses

No doubt the phenomenon is not a new one, but merely more prevalent of late: the case of legislation designed to protect the weaker members of society finding an application in an area for which it was never intended. If ever there was a paradigm case of this phenomenon it is section 52 of the Trade Practices Act. With the possible exception of section 92 of the Australian Constitution (that "little bit of layman's language" of Sir George Reid[1]), it must be nearly true that (with apologies to Sir Winston Churchill) never have so many sued about so many things on the basis of so few words.

The first growth area of section 52 was as a substitute for the action for passing off.[2] It continues to be productive. Of almost equal antiquity (if that term can be used of experience hardly 15 years old) is its use in relation to misrepresentation.[3]

It can hardly have been the intention of Parliament (in a subjective sense) that parties to major commercial transactions should be able to rely on this section to circumvent the rules of contract so painstakingly developed over so many years. yet that is where we appear to be heading. Moreover with the introduction of section 51A dealing with misleading statements as to the future, which contains a reversed onus of proof, the position has been aggravated.

Sections 52 and 51A are contained in Part V of the Act, headed "Consumer Protection" but the Courts have not been prepared to accept that the heading indicates any limitation to the application of the sections or to the persons who may rely on them for relief under sections 80 and 82.[4] Provided a transaction is in trade or commerce[5] it becomes a feature on a map which the searchlight of section 52 may seek out and place under scrutiny.

The concern is not with the application to dealings involving consumers, where it has become accepted that a standard of virtual strict liability applies to traders, who must assume that they are catering for the lowest common denominator — the stupid, ignorant and gullible.

Rather the concern is with the application of the section, and the new section 51A, in cases where both parties to a transaction are of substantially equal bargaining power and the subject matter is relatively complex. For example, a major commercial transaction, such as the sale of a business, may progress through a number of stages: the parties arrive at a bargain subject to formal contract; a period ensues during which information is disclosed and inquiries answered, often by professional consultants retained by the vendor; a draft agreement is produced and negotiated between the parties and their legal representatives and eventually signed. (During all of this time the process of disclosure and inquiry is continuing). The Agreement provides for further disclosure prior to completion. All of this process may take several months. Typically the Agreement would contain a clause to the effect that the Agreement and ancillary documents contain the entire agreement relating to the subject matter of the transaction where documented, and that the purchaser may not rely on any representation made by or on behalf of the vendor not contained in the documents.

If such "entire agreement" clauses are to be rendered ineffective by section 52 or section 51A, so that the purchaser can upset the transaction by adducing evidence of a representation made on behalf of the vendor at an early stage of the negotiations, commercial dealings and expectations will be thrown into disarray. Yet there are dicta abroad, presumably voiced per incuriam the types of transaction described above, which suggest that a disclaimer will not be effective in relation to a claim under section 52. The problem has arisen because the early cases in which these opinions have been expressed have involved factual situations, significantly different from those outlined in the last paragraph.

Thus in *P. J. Berry Estates Pty. Ltd. v. Mangalore Homestead Pty. Ltd. & Ors.* [6][(1984) ATPR 4I-489], a decision of Sweeney J., which is relied on in later cases, his Honour states that