

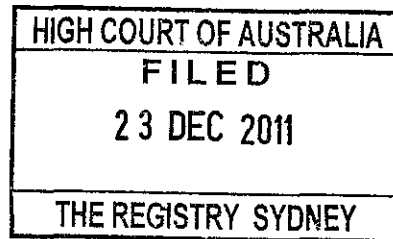
IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY
BETWEEN

No. S362 of 2011

INTERNATIONAL LITIGATION
PARTNERS PTE LTD

Appellant

and



CHAMELEON MINING NL
(RECEIVERS AND MANAGERS
APPOINTED)

First Respondent

CAPE LAMBERT RESOURCES
LIMITED

Second Respondent

ANDREW HUGH JENNER WILY

Third Respondent

DAVID ANTHONY HURST

Fourth Respondent

APPELLANT'S SUBMISSIONS IN REPLY AND ON NOTICES OF CONTENTION

PART I: CERTIFICATION

1. These submissions are in a form suitable for publication on the internet.

PART II: SUBMISSIONS IN REPLY ON APPEAL

2. **1R [28]:** ILP has previously relied upon the factual matrix of the Funding Deed by referring to the existence of a settlement offer prior to contracting. This was put at first instance below: transcript, 19 August 2010, 126/18-27, (Jackman SC).

PART III: SUBMISSIONS ON NOTICES OF CONTENTION

3. The Funding Deed is not a derivative within the meaning of s 761D(1). Alternatively, if it falls within the definition in s 761D(1), it is also "a contract for the future provision of services" within the meaning of s 761D(3)(b) of the Act, with the result that it is not a derivative for the purposes of Chapter 7.¹

¹ In the Court below, the reasoning on this issue can be found at Giles JA [74]; Young JA [238]; Hodgson JA [130] - [133]. The primary judge addresses the issue at J[78] - [79].

Dated 23 December 2011
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4. Derivative is defined in s 761D(1). Put shortly, a derivative is an arrangement for which the amount of the consideration, or the value of the arrangement, is ultimately determined, derived from or varies wholly or partly by reference to, the performance of an underlying benchmark (the “something else” in s 761D(1)(c)).
5. The derivative has no autonomous value. It must be tied to some reference, that is, the underlying benchmark. Further, the composition of the underlying benchmark itself is unchanging. In a derivative arrangement, while the quantity or the value of the underlying benchmark (e.g., an asset, a rate, an index) may fluctuate, the composition and identity of the benchmark itself remains constant.
- 10 6. Consequently, not every contingent arrangement is a derivative. Nor is any “external matter”, no matter how compositionally fluid or uncertain, capable of constituting an underlying benchmark for the purposes of a derivative arrangement. Properly construed, the “something else” in s 761D(1)(c) is not “anything at all”. Rather, the “something else” speaks only to such things as:
- (a) are external to the arrangement;
 - (b) possess the requisite certainty of composition; and
 - (c) are capable of fulfilling the functional element of derivative arrangements.
7. Section 761D(1) was inserted by the *Financial Services Reform Act 2001* (Cth)² as part of the new Part 7.1 of the *Corporations Act*. Derivatives received substantial attention in the drafting of Part 7.1. CLERP 6 described the situation thus:
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The current regulation of Australia’s securities and derivatives market is largely institution and product based. Financial instruments are regulated differently depending on how the instruments are legally classified.

Market regulation draws a distinction between “securities” and “futures contracts”. Generally, financial arrangements falling within the definition of “securities” are traded on a securities exchange, while arrangements within the definition of a “futures contract” are traded on a future exchange or an OTC [Over The Counter] futures market. “Derivatives” are not recognised as a distinct category by the Corporations Law and are regulated differently depending on whether they are classified as a security or a futures contract.

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... The definition of “futures contract” is widely acknowledged as unsatisfactory and the distinction between securities and futures is challenged by innovative financial products which exhibit characteristics of both types of instruments.³

8. It was to this mischief that the introduction into the Act of a definition of a derivative - specifically one covering “both types of instruments” - was directed:

From an economic perspective, the creation of a new regulatory regime based on the separate regulation of securities and derivatives would be inefficient as it

² The Act comprised the principal element of a legislative package also comprising the *Financial Services Reform (Consequential Provisions) Act 2001*, the *Corporations (Fees) Amendment Act 2001* and the *Corporations (National Guarantee Fund Levies) Amendment Act 2001*.

³ CLERP 6 (ISBN 0 642 26121 0) at pp. 33-32 (footnotes omitted). Cf *Sydney Futures Exchange Limited v Australian Stock Exchange Limited* (1995) 56 FCR 236, especially at 260, per Gummow J.

would regulate functionally similar products differently depending on their legal classification.⁴

9. A description of “Derivatives” was given in CLERP 6.⁵ However, the starting point for s 761D was the final report of the Companies and Securities Advisory Committee (CASAC), *Regulation of On-exchange and OTC Derivatives Markets*, published in June 1997.⁶ CASAC described “derivatives” (at [1.1]) as comprising an underlying benchmark with a fixed composition, but a fluctuating value or quantum:

Derivatives are financial market instruments whose values are derived from, or vary according to, the value of an asset or the level of a rate or index (the underlying). All derivative contracts are based on one or both of two primary elements:

- *the forward element*, under which there is an obligation to deliver or make a cash adjustment at some future time based on the current or future value of the underlying
- *the option element*, which gives the buyer of the option (the taker) the right, but not the obligation, to buy (call) or sell (put) the underlying at a certain stated price (the strike price) on or before a specified future date (the expiry date).

10. CASAC proposed a “deductive definition” for the purposes of amending the *Corporations Law*, defining a derivative as:

...any agreement:

- the value of which is ultimately derived from, or varies according to, the value of one or more assets, rates, indices or other underlying (derived value element), and
- whereby one or both parties, at some future time, may have to provide cash or other consideration (excluding any initial or periodic consideration that is fixed at the time the agreement is entered into) to the counterparty or a substitute counterparty (such as the clearing house), that consideration ultimately being determined in whole or part by reference to the derived value element (liability element).⁷

11. CASAC described the “derived value element” as the most commonly recognised feature of all derivatives. Archetypal kinds of underlying included: a physical commodity; a financial asset; energy products; an index; an interest rate or currency, or another derivative.⁸ The use of “ultimately” in s 761D(1) makes explicit this final possibility. The derived value element “covers derivatives over derivatives, including swaptions and options over options”.⁹

12. The drafting history – including the context and legislative purpose – of s 761D supports the following propositions. *First*, s 761D reflected a functional approach to regulation, intended to encompass instruments sharing similar functions regardless of

⁴ CLERP 6 at p. 37, footnote omitted

⁵ CLERP 6, Appendix C at p. 134

⁶ Explanatory Memorandum to the *Financial Services Reform Bill 2001* at [6.72]

⁷ CASAC, *Regulation of On-Exchange and OTC Derivatives Markets*, Final Report, June 1997, at p. 56, [3.33]

⁸ CASAC, *Regulation of On-Exchange and OTC Derivatives Markets*, Final Report, June 1997, at p. 57, [3.37]

⁹ CASAC, *Regulation of On-Exchange and OTC Derivatives Markets*, Final Report, June 1997, at p. 57, [3.38]

the specific product or institution to which each related. The relevant function of a derivative was the derivation of the amount of consideration or value of the arrangement by reference to fluctuations in the value or amount of an underlying benchmark of a fixed composition. *Secondly*, s 761D did not create an expanded category of “derivatives” encompassing arrangements fundamentally different in nature from those already in existence. The provision embraced, within an overarching category (“derivatives”), two kinds of instruments – futures contracts and securities – which had previously been separately and differently regulated, despite their functional commonalities. *Thirdly*, s 761D was drafted broadly, but not without limits.¹⁰ Specifically, the drafting was not intended to expand the scope of “derivatives” to include any arrangement for which value was contingent on “anything else”. Rather, it maintained the ordinary character of a derivative, whereby the consideration payable, or value of the arrangement, is determined, derived from or varies by reference to a benchmark.

13. The gist of CHM’s submissions (1R [56] – [67]) is that the Funding Deed is a derivative because the amount of the consideration, being the amount that one party provides to someone, is, in the case of ILP, the amount of the Legal Costs, which “depends upon” (1R[63]) the costs incurred by CHM in the Federal Court Proceeding, any Court orders as to security and any amounts payable by means of adverse costs orders. In the case of CHM, the consideration paid by it is “at least referable to” the Legal Costs, which renders these Legal Costs the reference point for all permutations of consideration payable by CHM. Each of these various “criteria” is said to be the relevant “something else”.
14. The gist of Cape Lambert’s submissions (2R [87] – [101]) is that the Funding Deed is a derivative because both the consideration payable by, and the value of the arrangement to, CHM is derived from or varies by reference to the value or amount of the costs of the litigation and the value or amount of a judgment in, or settlement of, the Federal Court Proceedings. The consideration payable by, and the value of the arrangement to, ILP are similarly derived from, or vary by reference to, the outcome of the proceedings.
15. The *first* error in the Respondents’ contentions is to read “something else” as including “anything else”. The *second* error is to read “something else” as including the happening of any outcome or event capable of having a calculable value or quantum. The *third* error is expanding this to include various equally possible contingent events, even though only one may ultimately occur: e.g., settlement; payment of a Resolution Sum; complete loss of the proceedings; counsel’s advice pursuant to cl. 13.2, and so on. Put differently, the compound notion of “the outcome of the proceedings” comprehends various, mutually inconsistent events, any one of which may, *ex ante*, occur. These errors result in the Respondents conflating a derivative with any contingent arrangement, and failing to appreciate the necessary role, and operation, of an underlying benchmark for the purposes of a derivative arrangement.
16. None of the aspects of the arrangements relied upon by the Respondents as constituting the “something else” for the purposes of s 761D, possesses the requisite compositional certainty of an underlying “something else”. As to the payment of Legal Costs, in all circumstances, the quantum of the Legal Costs payable is simply a function of the

¹⁰ Cf Giles JA at [72]-[73]; *Keynes v Rural Directions Pty Ltd* (2010) 186 FCR 281 at 416 [28], per Dowsett, Stone and Bennett JJ; and at first instance (2009) 72 ACSR 264 at 282 [87], 285 [95]-[96], per Besanko J

subject matter of the Funding Deed. ILP is paying (or having reimbursed to it) the Legal Costs that are incurred in prosecuting the proceedings. As to the Funding Fee and Early Termination Fee, to the extent that either can, in some circumstances, be calculated by reference to the Legal Costs, this is a contingent, but not a derivative, arrangement. There is no underlying benchmark from which a derived value element can be obtained. To the extent that the Funding Fee is a percentage of the Resolution Sum, this is the gross amount received by CHM by way of settlement, judgment or otherwise in the proceedings. The arrangement is again contingent, but not derivative.

- 10 17. The Appellant's construction of s 761D(1)(c) ascribes to "derivative" a meaning that accords with its accepted commercial connotation.¹¹ The Respondents' proposed construction of s 761D(1)(c) fails to do so: cf *Corporate Affairs Commission of New South Wales v Yuill* (1991) 172 CLR 319 at 339-340, per Gaudron J.
18. If contrary to the above, the Funding Deed falls within the literal ambit of s 761D(1), s 761D(3)(b) provides that a contract for future provision of services is not a derivative for the purposes of Chapter 7, even if covered by the definition in s 761D(1).
19. "Services" is not defined in the Act, but connotes an act of helpful activity, and the supplying of any articles, commodities, activities, etc required or demanded.¹²
- 20 20. Pursuant to the Funding Deed, ILP promises to provide various activities which help or assist CHM: recitals B and C; cl. 8.1(b); 8.3; 13.2, and 17.4. Further, the payment of money by ILP to or on behalf of CHM, pursuant to cl. 2.1 (and potentially cl. 6.1 and 6.2) of the Funding Deed, constitutes a service for the purposes of s 761D(3)(b). Money can itself be regarded as a commodity whose value depends upon its resale value.¹³ The provision of money by way of advances constitutes the provision of a service, by means of a loan or advance of money. As Hodgson JA correctly held ([133]), the advances of funds by ILP allowed CHM to procure legal services from third parties and constituted the provision of finance for an undertaking in which CHM was engaged; being money required or demanded by CHM, pursuant to the Deed, from time to time.
21. Accordingly, the Funding Deed falls within the exemption identified at s 761D(3)(b) of the Act, and is, in any event, deprived of statutory characterisation as a derivative.

30 **Dated: 23 December 2011**

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¹¹ R L Deutsch and M Saccasan, *Derivatives Demystified* (Sydney: Prospect Publishing, 1995) at 1; P R Wood, *Set-off and Netting, Derivatives, Clearing Systems* (London: Sweet and Maxwell, 2007) at 197.

¹² *Macquarie Dictionary* (5th edition) (2009) noun meanings (1) and (2) respectively. Cf Giles JA at [55].

¹³ C Proctor, *Mann on the Legal Aspect of Money* (6th edition) (Oxford: Oxford University Press, 2005), [1.28] – [1.30] & [1.43] – [1.59]; D Fox, *Money as Property* (Oxford: Oxford University Press, 2008) Chapter 1, pp. 1-48.