IN THE MATTER OF EMAIL LIMITED

AN APPLICATION UNDER SECTION 657EA OF THE CORPORATIONS LAW BY EMAIL LIMITED FOR REVIEW OF A DECISION TO REFUSE AN INTERIM ORDER

REASONS FOR DECISION

1. The Panel in this matter is constituted by Brett Heading (sitting President) Les Taylor (sitting Deputy President) and Maria Manning.

2. These are our reasons for our decision under section 657EA of the Corporations Law[1] to set aside a decision of another Panel and to substitute a decision to order Smorgon Distribution Limited (***Smorgon***) not to dispatch offers under a takeover bid in relation to all of the ordinary shares in Email Limited (***Email***) until 5.00 p.m. on 2 June 2000.

Panel's Function

3. The Panel's main function is to ascertain whether unacceptable circumstances exist in relation to a bid and, if they do, to take action by way of declaration and orders to remove those unacceptable circumstances (subsections 657A(1) and 657D(1) and (2)). Unacceptable circumstances are states of affairs which tend to defeat the achievement of the policies of Chapter 6, as set out in section 602 and reflected in the other provisions of the Chapter. They may arise from a contravention of Chapter 6 (paragraph 657A(2)(b)), but they can arise without a contravention (subsection 657A(1)).

Internal Review

4. Under section 657EA, a decision by the Panel is subject to review by another Panel, made up of another three members appointed under section 184 of the ASIC Act. The review Panel has the same powers as the original Panel, and can affirm, vary or set aside their decision. The review is a *de novo* reconsideration on the merits. In deciding what is the preferable decision in a particular case, a review Panel should apply the same policy as was applied by the original Panel, unless there are cogent reasons why that policy should not be applied generally or in that case: *Drake v Minister for Immigration and Ethnic Affairs (No. 2)* (1978) 2 ALD 634.

Interim Orders

5. The Panel also has a function of making interim orders under section 657E, even in the absence of a declaration that unacceptable circumstances exist. It is plain from paragraphs 657D(2)(a) and (b) and

[1] Statutory references are to provisions of the Corporations Law, as in force at 22 May 2000.

the place of section 657E in Part 6.10 that the objective of such an order must be to remove or forestall unacceptable circumstances.

6. In making an interim order, the Panel needs to consider whether unacceptable circumstances exist or would develop if the order was not made, and weigh the burden of the interim order against the mischief which would occur if the order was not made. In weighing those factors, the Panel must bear in mind that it has the power, and will have the opportunity, to make orders designed to rectify any defects in the relevant bid or in the disclosure concerning it, after a full consideration of the facts and issues. Not every mischief, however, can be overcome after it has arisen.

7. At the interim stage, the Panel generally needs to take at face value credible submissions made by the applicant for interim relief.

Background

8. On 2 May 2000, Smorgon lodged and served a bidder's statement and offer in relation to the bid. Email has sought interim and final relief in relation to the structure of the bid and the disclosure in the bidder's statement. That application is being considered by a Panel (the ***sitting Panel***) made up of Annabelle Bennett, Michael Tilley and Karen Wood.

9. The bid consideration is made up of $1.85 cash and a convertible appliance preference share in Smorgon (a CAP), which Smorgon proposes to convert into equity in a company which will own part of the present business of Email, referred to as the Appliance Company.

10. Subsection 621(3) requires the consideration offered under a bid to be equal in value to the highest price paid or agreed to be paid by the bidder or an associate during the 4 months before the bid. The bidder bought 5.4% of the ordinary shares in Email on market on 30 April 2000 for prices up to $2.89. For the bid to comply with subsection 621(3), the CAPs need to be worth $1.04 or more.

11. Because the bidder is offering scrip, paragraph 636(1)(g) requires the bidder's statement to comply with sections 710 to 713, the principal prospectus provisions. The bidder's statement sets out information about the rights attached to the CAPs. It also includes a report by SG Hambros, containing information about the businesses which would be included in the Appliance Company.

12. Email took exception to the structure of Smorgon's bid and the disclosures in the bidder's statement. It raised a number of issues, but the two most relevant to these proceedings are whether subsection 621(3) and section 710 would be complied with in relation to the bid.

The Late Amendment

13. After Email applied for relief, Panel staff asked parties to make submissions on Email's application for an interim order by 5.00 p.m. on 16 May. Solicitors for both companies complied with this deadline. Smorgon's solicitors proposed amendments to the bidder's statement which were designed to meet some, but not all, of the objections raised by Email. Each firm made a submission after the deadline, in response to the other.

14. Hambros sent a revised version of their report to the Panel and to Email by electronic mail just before midday on 17 May, when the sitting Panel met, as the parties were aware that it would. The revisions mainly affected four pages of their report and were designed to meet some, but not all, of the objections raised by Email to the original report.

15. PwC attempted to respond to Hambros' revised report, by telephone to the Panel's director, after the report was delivered and while the sitting Panel was conferring on another telephone link. That response could not effectually be delivered during the Panel's meeting, and it did not affect their deliberations.

Interim Order Refused

16. On 17 May 2000, the sitting Panel refused Email's application for an interim order restraining dispatch of offers under the bid and for other interim relief. Email applied for review of that decision under section 657EA, with the President's consent under subsection 657EA(2).

17. To prevent frustration of Email's right to a review of their decision, the sitting Panel ordered Smorgon not to dispatch offers until 5.00 p.m. on Friday 19 May. On 19 May, we extended that order until 5.00 p.m. on Monday 22 May, to have time to consider properly Email's review application.

Grounds of Review Application

18. The grounds on which Email sought review of the decision not to make an order restraining dispatch of the offers were:

    (a) the offers would contravene subsection 621(3) and would not comply with the equality principle in paragraph 602(c);

    (b) the bidder's statement would not comply with section 636, or with the information principle in paragraph 602(b)(iii).

    In effect the application was made under draft rule 4.3(c) (new materials). We set out our decision on the application, and then the reasons for that decision.

Our Decision

19. On 22 May, we upheld Email's application for review, as regards the dispatch of Smorgon's offers until the sitting Panel have considered the substantive issues raised by Email's original application. We ordered Smorgon not to dispatch offers under the bid until 5.00 p.m. on Friday 2 June, or until further order. This will allow the sitting Panel to make any necessary orders, if it decides in the light of its consideration of the substantive issues that Smorgon should be allowed to dispatch offers before that time, or should be restrained until after that time.

20. It was unnecessary for us to deal with the other issues raised by the review application. Given that offers will now not be dispatched until those proceedings are under way, each of those issues is more appropriately dealt with by the sitting Panel, in connection with their decision on the substantive issues.

Reasons - The Equal Access Point

21. Hambros in their report value the CAPs at between 87 cents and $1.21. In Smorgon's view, the bid complies with subsection 621(3), because the midpoint of that range is $1.04. Email submit that:
    (a) that valuation is too high, and
    (b) for the bid to comply with subsection 621(3), the lower end of the range must be $1.04 or more.

22. Email submit that the CAPs are worth less than the $1.04 needed to comply with subsection 621(3), and that shareholders would be unfairly affected by a breach of the subsection. They add that it is an important provision, designed to implement a fundamental policy of Chapter 6, namely that all holders of shares in a bid class have reasonable and equal opportunities to participate in the benefits arising under a bid, and that any failure to comply with that provision and that policy would be unacceptable.

Sitting Panel's Reasons – Subsection 621(3)

23. The sitting Panel made no final decision whether the bid would contravene subsection 621(3) or fail to comply with paragraph 602(c). However, it decided that the possibility of a breach of subsection 621(3) was not a reason to hold up dispatch of Smorgon's offers, as orders could be made that the consideration be increased or the bid abandoned, in time for bid contracts to be effectively cancelled before they were performed.

Our Decision – Subsection 621(3)

24. We agree with the sitting Panel. As Email say, subsection 621(3) and the policy for which it stands are fundamental and it is not yet clear whether they will be contravened, but it does not follow that the question of breach must be dealt with at the interim stage.

25. No permanent mischief will result from a failure to comply with the equal access policy, or from a breach of subsection 621(3), if Smorgon is prevented from declaring offers and bid contracts unconditional until the sitting Panel decides this issue and (if need be) makes orders requiring the offers to lapse or be increased. Had this been the only ground, we would have allowed Smorgon to dispatch offers, but ordered it not to declare them unconditional until 2 June, and published that order.

Reasons - The Disclosure Point

26. The issues about disclosure relate to risk disclosure concerning the spin-off of the Appliance Company and concerning the CAPs, financial information about the bidder and the Smorgon Steel group and information about the bidder's relationship with the other companies in that group.

27. Email contended that the bidder's statement contained misleading statements, as well as not containing information sufficient to satisfy section 710. Email submitted that the market's integrity would be seriously jeopardised if the bidder's statement was materially misleading when it was dispatched. In support of that submission, Email pointed to a number of features of the bidder's statement, which it regards as defective.

28. Section 710 requires the bidder's statement to set out, to the extent that offerees and their professional advisors would reasonably expect that information in the bidder's statement, all of the information that they would reasonably require to make an informed assessment of:
    (a) the rights and liabilities attached to the securities, and
    (b) the assets and liabilities, financial position and performance, profits and losses and prospects of the issuer of the securities (namely the bidder).

The CAPs

29. The CAPs are issued as preference shares in the bidder. The bidder intends to convert them into equity in the Appliance Company. To date, no Appliance Company has been designated: the choice of vehicle will depend on tax and commercial considerations. How shares in the Appliance Company are to be provided to Email shareholders will also

depend on how the bidder is to be reconstructed to spin off the Appliance Company, which may involve difficult issues of company law.

30. Accordingly, there are three elements to the value of the CAPs:

    (a) the value of a CAP, if it converts into a share in the Appliance Company;
    (b) the value of a CAP, if it remains a preference share in the bidder; and
    (c) the likelihood that it will in fact convert.

31. Smorgon does not promise to secure conversion of the CAPs into equity in the Appliance Company. There could be no straightforward contract to that effect. The precise nature of the Appliance Company, the detail of the businesses and intellectual property it would own, its debt burden, the method of conversion, the commercial and tax consequences of the conversion and the time frame for the conversion are all matters which as yet Smorgon does not know, and which it cannot yet decide.

32. Instead, Smorgon states that it intends to convert the CAPs into equity in the Appliance Company and to distribute shares in the Appliance Company to accepting offerees and (if Smorgon does not achieve compulsory acquisition) continuing ordinary Email shareholders. It then stated:

    Ultimately, if the CAPs have not been converted or exchanged by 30 September 2002 or if the Bidder considers that a spin off is not practicable or feasible or would result in undue expenses or tax for the bidder or any subsidiary, the CAPs may (at the Bidder's election) … be redeemed for $1.04.

33. The amendments proposed by Smorgon on 16 May:

    (a) gave firmer form to this expression of intention: Smorgon must use all reasonable endeavours to achieve the conversion;
    (b) provided for the Appliance business to be sold, if it could not be spun off;
    (c) provided for the redemption price to reflect the price for which the Appliance business had been sold, if that price exceeded $1.04 per CAP; and
    (d) stated that it is Smorgon's intention to redeem the CAPs, if they cannot be converted by 30 September 2002.

34. The amended bidder's statement (and terms of issue of the CAPs) do not require redemption of the CAPs by any fixed date, if they are not converted, or that the preference dividend reflect the price received for the Appliance business, if it is sold.

The Prospectus Information

35. Compliance with section 710 was divided between the bidder's statement proper and Hambros' report. The bidder's statement sets out the rights and liabilities attached to the CAPs and describes the proposal to convert them into, or replace them with, equity in the Appliance Company.

36. Hambros' initial report concentrated on the value of a CAP, if it converts into a share in the Appliance Company. It estimated the value of a CAP, if it remains a preference share in the bidder, but gave little reasoning, and few figures, to support this limb of the valuation. It did not assess the likelihood of conversion (that assessment being in the bidder's statement proper), but instead assumed that the shares would in all likelihood be converted.

37. The revisions Hambros made in the revised report submitted to the Panel at midday on 17 May consisted relevantly of supporting data for the valuation of the CAPs as preference shares in the bidder. Hambros provided an assessment of the yield on the shares and of an appropriate discount factor, having regard to comparable quoted securities. They did not provide additional information about the assets and liabilities, financial position and performance, profits and losses and prospects of either the bidder or Smorgon Steel Group Limited, which is the holding company of the bidder and which the bidder has joined in a Deed of Indemnity in favour of the National Australia Bank.

PricewaterhouseCoopers' (PwC's) Reports

38. Email commissioned an analysis of Hambros' report from PwC, who criticised Hambros' valuation of the Appliance Business. PwC's report set out an alternative view on the value of the Appliance Company. We accept that PwC's valuation is an alternative view which is open to an expert, but this part of the PwC report did not discredit Hambros' valuation in the sense of establishing that it was misleading. Had that been all, we would not have objected to the dispatch of the Hambros report, although we would have wanted both valuations published in due course, to give the market the benefit of alternative assessments.

39. However, PwC's report dealt harshly with Hambros' acceptance that it was likely the CAPs would convert to equity in the Appliance Company and with their valuation of the CAPs, considered as ongoing preference shares. If those criticisms are sustained, the Hambros report (and therefore the bidder's statement) is seriously misleading.

40. Briefly, PwC argue that Smorgon is under no obligation to procure the best outcome for holders of the CAPs, and that it would be irrational for Smorgon to do so. Accordingly, the CAPs should be valued on the basis

that they will convert into equity in the Appliance Company, only if Smorgon decides that the Appliance Company is worth less than $1.04 per share. In effect, Smorgon would have a put option over the Appliance Company, which it would exercise if the Appliance Company was worth less than $1.04 per share, but not otherwise.

41. PwC conclude that the value of a CAP is between 67 and 79 cents. That valuation is heavily influenced by their assessment of the value of an ongoing preference share in the bidder, and of the likelihood of conversion. They give reasons for that view, which are more detailed than Hambros' reasons for their corresponding valuation. They also attack the basis of Hambros' valuation of the CAPs as preference shares.

42. It is not our function to make a final assessment of PwC's criticisms and alternative valuation. However, they are detailed and, on an initial review, they appear to be convincing. The gulf between the range of values suggested by Hambros and that proposed by PwC is very wide.

Sitting Panel's Reasons –Disclosure Issue

43. The critical reason for the sitting Panel's decision on the disclosure issue was given as follows:

"33. In our view, the amended bidder's statement is fit to be dispatched. Additional information and clarifications may be necessary. Some of these will be appropriately made in the target's statement, and others we may require to be made by supplementary bidder's statement, when we have considered the substantive issues. However, the possible need for these additions and clarifications does not give rise to unacceptable circumstances.

34. In particular, the change in the terms of the CAPS largely deals with the issue over the optionality of the CAPS and the additional information in the Hambros report will allow holders and their advisors to assess the merits of the CAPS, using a methodology appropriate to continuing quasi-debt securities."

44. This applies a policy that the Panel should not restrain dispatch of a bidder's statement, notwithstanding credible claims that it is defective, if the alleged defects would not give rise to unacceptable circumstances, because they consist of omissions, which could be rectified by later disclosures.

Our Decision – Disclosure Issue

45. We agree with this policy. However, whether the alleged deficiencies would be satisfactorily overcome by subsequent disclosures is a matter of fact and degree. We have been able to review the oral submission made by PwC to the director on 17 May and submissions by both parties in relation to the application for review. With the benefit of much more

time than the sitting Panel and a little more information, we reluctantly came to a different assessment of the facts.

46. In our view, the additional information provided by Hambros does not entirely overcome the deficiencies in the original report. It still contains no pro forma balance sheet or profit and loss statement for the bidder or for Smorgon Steel Group Limited, and only indirect information about the creditworthiness of Smorgon Steel.

47. There is much information in the public domain about Smorgon Steel, which is a disclosing entity, but not about the additional debt which the Smorgon Steel group would undertake in taking over Email, and there is no previous information about the bidder.

48. In addition, PwC's criticism of Hambros' valuation of the CAPs as ongoing preference shares is telling. A CAP is a complex security of uncertain value. Hambros make the most of it, if not more; PwC make the least of it, if not less. The truth is likely to lie somewhere between.

49. We are satisfied, however, that PwC have raised a serious concern that the Hambros report values the CAPs too high, particularly as ongoing preference shares. If the Hambros report is wrong in that respect, its publication will propagate an erroneous view as to the value of the CAPs. The propagation of that error, and the difficulty of removing it, would give rise to unacceptable circumstances. Accordingly, the report should not be dispatched, until it has been reviewed by the sitting Panel.

The Late Amendment, Again

50. As we narrate at paragraphs 12 to 14, Hambros lodged an amended report at almost precisely the time the sitting Panel was due to meet to consider matters which included that report. Hambros had done a considerable amount of work in two days, and perhaps they needed all of that time. But the eventual effect of the late submission was counterproductive. It has caused increased costs and delay to parties (not least their own client) and to the Panel.

51. The sitting Panel accepted the late submission of the report: it was squarely relevant, a decision had to be made that day, and there were other calls on their time. But they had very little time to assess the changes and to consider how far they met PwC's criticisms from the previous day, and none to consider PwC's further response by telephone. Had the sitting Panel had adequate time to consider the revised report, we would have been even more hesitant to differ from them.

52. This matter has been distinguished by parties' attempting to have the last word, working late on submissions which are lodged late, or

responding after a deadline to submissions which were lodged at the deadline. Both parties made further submissions after it was appropriate for them to do so, and may have done their respective positions more harm than good by doing so.

53. There is more to natural justice than simply allowing parties to make submissions: it also involves reading them with due attention. At the end of the day, the Panel is entitled to take a short time to assess the submissions that have been made, and for that purpose to treat them as final.

Brett Heading
28 June 2000