

## IN THE MATTER OF PINNACLE VRB Ltd (No. 2)

An application under sections 657A, 657D and 657E of the Corporations Law by Federation Group Limited for a declaration and orders in relation to a takeover bid by Federation for all of the ordinary shares in Pinnacle VRB Limited.

### - Federation Group's Application

1. The sitting Panel in this matter comprises Simon McKeon (President), Professor Ian Ramsay (deputy President) and Robyn Ahern.
2. Federation Group Limited (*Federation*)<sup>1</sup> applied on 16 October 2000, for a declaration of unacceptable circumstances under section 657A of the Corporations Law (Law) and orders under sections 657D and 657E of the Law. The application was in respect of statements issued by Pinnacle VRB Limited (*Pinnacle*) which Federation believed affected Federation's bid for Pinnacle.
3. Instead of making those declarations and orders, we requested Pinnacle to provide additional information in the form of a supplementary target's statement. These are our reasons for that decision.<sup>2</sup> The Panel announced its decision on 6 November, 2000.

### Background

4. Pinnacle is a company listed on the Australian Stock Exchange (*ASX*).
5. Pinnacle acquired from Unisearch Limited the ownership of the intellectual property concerning an electrolyte storage technology using vanadium redox batteries (*VRB*). The technology is used for the storage of electricity for domestic and commercial installations to supply electricity when required, as well as to smooth peaks and troughs in mains power.
6. Pinnacle has licensed Federation to exploit and utilise VRB technology in all of Africa other than Egypt and the Middle East. Federation has assigned that licence to Vantack (VRB) Technology Corporation (*Vantack*), a 51% owned subsidiary listed on the Canadian Stock Exchange.
7. The technology is at an early stage of commercial development, with some full scale commercial systems installed in Japan and others under construction. To date the only full scale systems using Pinnacle's technology have been built in Japan by Sumitomo Electric Industries (*Sumitomo*) as well as by Mitsubishi Chemicals Corporation with Kashima Kita Electric Corporation (*Mitsubishi*). Sumitomo and Mitsubishi are both licensees of Pinnacle's VRB technology for use in Japan.
8. Pinnacle does not itself build VRB systems. Pinnacle has an agreement with Sumitomo "under which Sumitomo will provide technical and engineering support to Pinnacle in respect of VRB projects outside Japan. This alliance enables Pinnacle to pursue the business of selling or providing commercial scale VRB vanadium energy storage systems worldwide."<sup>3</sup>

9. Since August 2000, four out of Pinnacle's five directors (including the managing director) have left the Board and four new directors have been appointed. The company secretary has also resigned and been replaced.

### The Bid

10. Federation has made three concurrent takeover bids for all of the shares and options issued by Pinnacle. It offered 2 shares in Federation for every 11 shares in Pinnacle and one share for every 8 options (there are two classes of options). Its bidder's statements (the *Bidder's Statement*) are dated 18 September. Offers were posted on 2 October and were due to close on 3 November.<sup>4</sup> The offers were originally conditional on 30% minimum acceptances and on no prescribed occurrences taking place, but all conditions were waived on 26 October. On 17 October Pinnacle lodged and dispatched its target's statement in response to all three bids (the *Target's Statement*).

### The Pinnacle letter of 9 October

11. On 9 October, Pinnacle released to ASX a letter which was posted to Pinnacle's share and option holders (the *Pinnacle letter*). Federation's original application to the Panel concerned a paragraph in the Pinnacle letter.

12. On 10 October, Federation made an announcement to ASX, taking issue with the statements in the letter. This announcement was not posted to Pinnacle share and option holders.

### The Sumitomo Order

13. The Pinnacle letter contained the passage:

'... the new board of Pinnacle has on a one off basis consented to supply Federation and Vantack, through the company's manufacturer, the cell stacks and rubber tanks to assemble a redox battery demonstration system for ESKOM's subsidiary TSI'.<sup>5</sup>

14. The Pinnacle letter included a copy of Federation's own announcement of the same transaction, made on 20 September, which states that:

'Vantack has concluded a supply agreement with Sumitomo for cell stacks required for its first commercial large scale Vanadium Redox Battery'.

15. This issue is not dealt with in the Bidder's Statement, which is dated 18 September, two days before Federation announced the agreement with Sumitomo.

16. Federation took exception to the statement above, as representing that Pinnacle, and not Vantack, had taken the initiative over the ESKOM system. This needs to be seen in the context of the Federation bid, which is in part a contest over whether Pinnacle or Federation will be the better management for the commercial development of the VRB technology. As part of this contest

Pinnacle and Federation are competing for the credit in taking the initiative in the manufacture of VRB equipment.

17. Pinnacle is not supplying equipment for the ESKOM system, directly or through Sumitomo. Its consent was sought and obtained to the agreement between Sumitomo and Vantack (although it is not certain as to whether that consent was formally required). If Pinnacle share and option holders take the relevant sentence to mean that Pinnacle had taken the initiative over this project, they may misunderstand the roles of Pinnacle and Federation in marketing the VRB technology in Africa.

### *Installed Base*

18. The Pinnacle letter went on to say of the ESKOM system:

"No delivery date has been set, nevertheless upon its instillation it will become the ninth VRB instillation. The worldwide installed vanadium energy storage systems now totals 10,820kW and after this instillation (sic) the total will increase to 11,320kW. Pinnacle will be entitled to sales and royalties from this instillation (sic)." <sup>6</sup>

19. This passage is in some respects imprecise. The ESKOM system is due to be completed in the first quarter of 2001. <sup>7</sup> The overall power of installed VRB systems is about 950 kilowatts and their overall storage capacity is about 4100 kilowatt hours. <sup>8</sup> The discrepancy results partly from confusion between kilowatts and kilowatt hours and partly from counting systems which have not yet been completed.

### *Royalties*

20. Pinnacle may not be entitled to royalties from the ESKOM system: since it is only a demonstration system, Vantack is not selling it to ESKOM.

### **The Application**

21. Federation initially applied on 16 October for:

- a. Interim orders under section 657E that Pinnacle post to each of its share and option holders a notice that Federation has sought orders from the Panel in relation to the Pinnacle letter and that Pinnacle make an announcement to ASX to the same effect.
- b. A declaration that the circumstances resulting from the Pinnacle letter are unacceptable, because the letter is misleading and may adversely affect the success of Federation's proposed acquisition of a substantial interest in Pinnacle under the takeover bids.
- c. Orders under section 657D that Pinnacle make a corrective announcement to 'acknowledge the matters set out in Federation's announcement' of 10 October and post copies to its share and option holders.

## The Target's Statement

22. On 17 October (after Federation made this application), Pinnacle lodged and posted its Target's Statement. This contains a review of the current operations of Pinnacle, the commercial development of the VRB technology and the strategy and direction of the new Board of Pinnacle, and argues that Pinnacle has better financial capacity than Federation for this development.

23. On page 12 of the Target's Statement, there is a table of installed and planned VRB systems. It contains two minor errors. One system is described as already installed at 17 October 2000, although the table itself indicates that it is not due for completion until 20 December 2000. The table does not mention that another system has a maximum power output for very short periods which is double its rated power output, which is correctly given in the table. The erroneous figures in the Pinnacle letter are not mentioned or expressly withdrawn.

24. The Target's Statement did not repeat or correct the statement in the Pinnacle letter about the ordering of the ESKOM system. The system is noted in the table of installed and planned VRB systems and there are other references to Federation's use of the VRB technology.

## Federation's Amended Application

25. Federation amended its application to seek corresponding relief in relation to statements in Pinnacle's Target's Statement about:

- a. the existence of rival vanadium battery technologies;
- b. whether the value of the VRB technology would be split if Federation obtained partial control of Pinnacle;
- c. whether Federation's offer represented a premium over Pinnacle's previous share price; and
- d. the availability of scrip rollover relief from capital gains tax for offerees.

26. Federation also sought a declaration of unacceptable circumstances on the basis that Pinnacle had not devoted adequate care to ensuring that its Target's Statement was complete and accurate.

## Other Omissions from the Target's Statement

27. After the Target's Statement was issued, Expectation Pty Ltd (*Expectation*) contacted ASIC, which notified the parties and the Panel of Expectation's concerns. Briefly, Expectation's position is that the previous Board of Pinnacle had granted a licence to Expectation to exploit the VRB technology, which gives Expectation:

- a. an exclusive licence in Taiwan and South Korea;
- b. a non-exclusive licence in all other territories outside Asia in which Pinnacle has already granted non-exclusive licences; and

c. a first right of refusal over new and renewed exclusive licences.

28. The grant of the Expectation licence had not been announced to ASX and it was not discussed in the Target's Statement. Pinnacle had announced to ASX on 29 May 2000 arrangements, pursuant to a Letter of Agreement, to enter into a series of agreements with Expectation. No further ASX announcement in relation to entering into a formal licence or other agreement with Expectation has been made by Pinnacle. However, the licence granted was wider than contemplated in that agreement and conditions and other aspects of that agreement were abandoned or not finalised. Pinnacle advises us that it did not mention the Expectation licence because it had doubts about its validity. The validity of the licence is now being tested in Supreme Court proceedings.

29. In addition, the Target's Statement did not mention the dispute or risk of legal proceedings between Pinnacle and its previous Managing Director over various matters connected with his previous office.

### **Findings on Materiality**

30. The statement in the Pinnacle letter about the ordering of the ESKOM system is deceptive, although it relates to a transaction which is in itself minor. The omission of any information at all about the Expectation licence was a major lapse of judgement on the part of Pinnacle. Each of these was sufficient to require a corrective document to be sent to shareholders. Several (not all) of the other matters raised by Federation relate to real defects in the Target's Statement, and it was appropriate to require them to be remedied.

### **Relevant Principles**

31. We were concerned about these misstatements and omissions. As a listed company and a company subject to a takeover bid, Pinnacle must use the utmost care in preparing and checking its ASX announcements and takeover documents for completeness and accuracy.

32. This is the consistent policy of the Corporations Law and the Listing Rules. A number of provisions of both support this obligation.

- A. Listing Rule 3.1 requires a listed company to make timely disclosure of price-sensitive information of which it is aware. For this purpose, a company is aware of information if a director or other person concerned in the management of the company ought reasonably to have come into possession of the information in the course of their duties.<sup>9</sup> Accordingly, the rule requires continuous vigilance to discover and report price-sensitive information concerning the company.
- B. Subsection 1001A(2) underpins the Listing Rule, imposing civil sanctions for a material contravention, even if it is merely negligent, and making a reckless or deliberate breach an offence.
- C. More generally, under sections 1308 and 1309 a company and its directors can commit an offence by failing to take reasonable steps

to ensure that a document lodged with ASIC or ASX is not false or misleading in a material respect.

- D. Similarly, it is an offence under section 999 to make a statement which is likely to have certain effects on trading, if the person making the statement ought reasonably to have known that the statement was false or misleading in a material particular.
- E. Section 670A prohibits the issue of a target's statement (or other document the contents of which are specified in Chapter 6) which contains deceptive or misleading matter, or from which required matter is omitted.<sup>10</sup>
- F. Where section 670A does not apply to a document (in effect, if Chapter 6 does not specify the contents of the document), section 995 applies if the issue of the document constitutes deceptive or misleading conduct.

33. Similarly, General Principle 5 of the London City Code states that:

"Any document or advertisement addressed to shareholders containing information or advice from an offeror or the board of the offeree company or their respective advisers must, as is the case with a prospectus, be prepared with the highest standards of accuracy."<sup>11</sup>

#### Application to Pinnacle

34. Pinnacle's share and option holders now have a particular need for complete and reliable information about the company's position and prospects. Pinnacle's affairs are in flux, not only because of the recent turnover of the Board and of Federation's bid, but also because the company now has an opportunity to make a commercial success of the VRB technology.

35. Granted that Pinnacle's affairs have been complicated by the recent removal of most of the previous Board and the installation of new directors, strenuous efforts were needed to provide full information to the market and to share and option holders about the company's position and prospects.

36. In this context, we have been disappointed by the repeated omissions from, and defects in, Pinnacle's releases. In particular, the Expectation licence could be very material (for good or ill) to Pinnacle's prospects of profiting from the commercial development of the VRB technology. In the time available, Pinnacle could not be expected to say definitively whether the Expectation licence was valid, but its existence and its possible effect on Pinnacle's prospects needed mention.

37. The misstatements and omissions are material to decisions which share and option holders need to make over Federation's bid. Accordingly, they were capable of giving rise to unacceptable circumstances under:

- a. paragraph 602(a) which requires that the acquisition of control over the voting shares in a listed body take place in an efficient, competitive and informed market; and

- b. paragraph 602(b)(iii) which requires that shareholders are given enough information to enable them to assess the merits of a proposal to acquire a substantial interest in the company.

## Decision

38. Pinnacle, however, indicated that it was prepared to issue a corrective statement and post it to share and option holders. Given this willingness to comply and the recent changes in Pinnacle's management, we decided that a declaration of unacceptable circumstances would be excessive. Federation agreed to extend its bid by 14 days. Since a corrective statement could be issued in time for share and option holders to have it a week before Federation's offers closed, we decided that interim orders were unnecessary.

39. Accordingly, we asked Pinnacle to prepare an additional statement (the *Supplementary Target's Statement*) incorporating corrections to the Pinnacle letter and to the Target's Statement. It also includes information concerning the Expectation licence. Federation and Expectation have had the opportunity to comment on the supplementary target's statement in draft.

40. The Supplementary Target's Statement was released to ASX on 1 November and posted to Pinnacle share and option holders on 3 November.

## Costs Order

41. Federation sought an order for its costs. We decline to make that order, for two reasons. First, the Panel has power to make a costs order only where it has made a declaration of unacceptable circumstances.<sup>12</sup> An undertaking to the Panel under section 201A of the ASIC Act would be an unwieldy and perhaps inappropriate substitute for an order. Secondly, Panel policy to date has been to make costs orders only where a party has caused needless delay or expense to other parties or to the Panel.

42. We are aware, however, of the burden on a party such as Federation in bringing proceedings such as these, and that a party may be at fault because of conduct outside Panel proceedings, even though it is responsive and facilitative in the proceedings themselves. Accordingly, we have asked the Panel Executive to re-examine this policy and report back to the full Panel. However, the outcome of that inquiry will not affect our decision in this case.

## Other Orders

43. Accordingly, we decline to make the orders sought by Federation. We thank all parties for their ready co-operation in short time frames.

Simon McKeon  
28 November 2000

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1 . Formerly Federation Resources NL.

2 . Findings of fact in these reasons are based on the bidder's statement, target's statement, ASX announcements and submissions mentioned in these reasons. Unless otherwise stated, statutory references are to the Corporations Law.

3 . Page 10 of the Target's Statement, mentioned below.

4 . The offer period has since been extended.

5 . ESKOM is the major electricity generator in South Africa.

6 . Quoted verbatim.

7 . This date was not mentioned in the Federation announcement of 20 September.

8 . The table on page 2 of the Supplementary Target's Statement discussed below lists installed and planned systems, and the relationship between the power and capacity figures.

9 . See ASX Listing Rules 3.1 and 19.12 and Guidance Note Continuous Disclosure: Listing Rule 3.1 16 November 1998.

10 . Oddly, mere ignorance of the defect is a defence: subsections 670D(1) and (2). Contrast section 731, repealed subsections 704(6) and (8) and paragraphs 7.99 and 7.113 of the Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998.

11 . The Panel on Takeovers and Mergers, The City Code on Takeovers and Mergers and The Rules Governing Substantial Acquisitions of Shares (6th ed, 2000), p B2. See also Rule 19, p 11- 18.

12 . Subsections 657D(1) and (2). The Panel will discuss this limitation with the Government.