

In the matter of Pinnacle VRB Ltd (No. 03)
[2001] ATP 2

Catchwords:

Review of ASIC decision - approach of Panel - options acquired under takeover bid - exemption sought to permit exercise of options - ASIC exemption sought - effect of draft, unpublished ASIC policy - exception in section 611 item 3 not completely satisfied - effect of disclosures in bidder's statement - legislative policy for exception - variation of ASIC declaration

Corporations Law (Cth), sections 611 item 3, 655A, 656A

Companies and Securities Advisory Committee (Legal Committee), Report on Anomalies in the Takeovers Provisions of the Corporations Law, March 1994 referred to

Allstate Explorations NL v Beaconsfield Gold NL (1996) 14 ACLC 973 considered

Re Becker (1977) 1 ALD 158 applied

Green v Crusader Oil NL (1985) 4 ACLC 118 referred to

Re Otter Gold NL and ASC (1997) 15 ACLC 387 considered

On 7 February 2001, we upheld an application by Federation Group Ltd under section 656A of the Corporations Law for review of the decision of the Australian Securities & Investments Commission dated 24 January 2001 under section 655A of the Law in relation to the acquisition by Federation of ordinary shares in Pinnacle VRB Limited which result from the exercise of options acquired by Federation under its takeover bids for Pinnacle.

Our decision is to vary ASIC's decision by omitting the conditions which it attached to the exemption it granted to Federation on 29 January 2001.

These are our reasons for that decision.

REASONS FOR DECISION

1. The sitting Panel in this matter comprises Les Taylor (President), Trevor Rowe (sitting Deputy President) and Maxine Rich.
2. These are our reasons for deciding to vary the relief granted by the Australian Securities and Investments Commission (ASIC) on 29 January 2001, by removing the conditions imposed by ASIC on the exemption it granted to Federation Group Ltd (*Federation*) to enable it to acquire ordinary shares in Pinnacle VRB Limited (*Pinnacle*) by exercising options acquired by Federation under its takeover bids for Pinnacle.
3. Under section 656A, the Panel may review a decision of ASIC under section 655A and may affirm, vary or set aside the decision. For these purposes, we have the same discretions and obligations as ASIC. If, in making the decision under review, ASIC applied a consistent

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administrative policy, we should in general apply that same policy, but we must make our own assessment of the facts to which we apply it and of the preferable application of the policy to the facts.¹

Background

4. Pinnacle is a company listed on the Australian Stock Exchange (*ASX*). Some time ago, Pinnacle acquired intellectual property from Unisearch Limited 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.
5. Pinnacle has licensed Federation, which is also listed on the *ASX*, to exploit and utilise *VRB* technology in all of Africa other than Egypt and the Middle East. Federation has assigned that licence to Vanteck (*VRB*) Technology Corporation (*Vanteck*). Vanteck is a 51% owned subsidiary of Federation, and is listed on the Canadian Stock Exchange.
6. Pinnacle had the following securities on issue:
 - (a) ordinary shares (*Pinnacle Shares*);
 - (b) options to acquire ordinary shares in Pinnacle exercisable at 20 cents on or before 1 February 2001 (*PA Options*);
 - (c) options to acquire ordinary shares in Pinnacle exercisable at 20 cents on or before 30 January 2002 (*PB Options*); and
 - (d) options to acquire ordinary shares in Pinnacle exercisable at 30 cents on or before 4 August 2002 (*Unlisted Options*).

The *Pinnacle Shares* and the *PB Options* are quoted on the *ASX*. Until they expired, so were the *PA Options*.

7. On 2 October 2000, Federation made three concurrent off market takeover bids for all of the *Pinnacle Shares* and all of the *PA* and *PB Options* (together, the *Options*). Federation offered the following consideration under its bids:
 - (a) 2 ordinary shares in Federation (*Federation Shares*) for every 11 *Pinnacle Shares*;
 - (b) 1 Federation Share for every 8 *PA Options*; and
 - (c) 1 Federation Share for every 8 *PB Options*.

¹ *Re Becker* (1977) 1 ALD 158.

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8. The Federation Shares are also listed on the ASX.
9. Federation's bidder's statements (the *Bidder's Statements*) are dated 18 September 2000. Offers were posted on 2 October and were due to close on 3 November, but were later extended to 29 December. The offers were originally conditional on 30% minimum acceptances and on no prescribed occurrences taking place,² but all conditions were waived on 18 October.³ On 17 October Pinnacle lodged and dispatched its target's statement in response to all three bids (the *Target's Statement*).⁴
10. Federation had no relevant interest in any Pinnacle securities prior to making its bid.⁵
11. The following table shows the number of Pinnacle securities on issue⁶ and the closing price for those securities as at 18 September 2000, and the number and percentage of securities acquired by Federation as a result of its offers:

| | Number of securities on issue | Closing Price | Number acquired by Federation | Percentage acquired by Federation |
|-------------------|-------------------------------|---------------|-------------------------------|-----------------------------------|
| Federation Shares | - | \$3.12 | - | - |
| Pinnacle Shares | 40,135,156 | 57 cents | 4,254,327 | 10.6 |
| PA Options | 14,499,368 | 38 cents | 7,204,736 | 49.69 |
| PB Options | 6,928,453 | 38 cents | 353,351 | 5.1 |
| Unlisted Options | 150,000 | - | - | - |

12. If Federation were to exercise all of its PA Options, its voting power in Pinnacle would be between 18.92% and 24.45%. The table below illustrates the range of outcomes, depending on which options were exercised:

| Federation's PCEOA Options | All Other PCEOA Options | Federation's PCEOB Options | All Other PCEOB Options | Federation's voting power in Pinnacle |
|----------------------------|-------------------------|----------------------------|-------------------------|---------------------------------------|
| ✓ | ✗ | ✗ | ✗ | 23.89% |

² Federation's Bidder's Statement for Pinnacle Ordinary Shares, page 19

³ ASX Announcement dated 18 October 2000

⁴ ASX Announcement dated 17 October 2000

⁵ Federation's Bidder's Statement for the Pinnacle Shares, page 80

⁶ As stated in the Bidder's Statements, based on publicly available information as at 18 September 2000.

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| ✓ | ✓ | ✗ | ✗ | 20.66% |
| ✓ | ✗ | ✓ | ✗ | 24.45% |
| ✓ | ✓ | ✓ | ✓ | 18.92% |

13. On 16 January 2001, Federation applied to the Australian Securities and Investments Commission (*ASIC*) for relief under section 655A(1) of the Law to unconditionally exempt Federation from the prohibition in section 606(1) in relation to the acquisition of ordinary shares in Pinnacle resulting from the exercise of the Options which Federation acquired as a result of its takeover offers.
14. On 24 January 2001, ASIC notified Federation that it had refused to grant the relief requested (*ASIC's Decision*). At the same time, however, ASIC advised Federation that, to enable Federation to appeal ASIC's decision if it wished to do so, ASIC would grant relief to enable Federation to exercise the Options, conditional upon Federation:
- (a) not exercising any resulting voting power in Pinnacle in excess of 20%;
 - (b) divesting such number of Pinnacle shares as is necessary to reduce its voting power in Pinnacle to not more than 20% within 14 days of the date of ASIC's relief.

An instrument granting this conditional relief was executed on 29 January 2001 (the *ASIC Instrument*).

15. On 22 January 2001, Reliable Power Inc (*Reliable*), a company based in the United States, announced that it would make an off market takeover bid for all Pinnacle Shares conditional upon a minimum acceptance of 51% of the Pinnacle Shares on issue. Under its bid, Reliable is proposing to offer 55 cents for every Pinnacle Share.
16. By the time the PA Options expired on 1 February 2001, Federation had exercised 6,863,895 of its PA Options and 221,785 of its PB Options (a total of 7,085,680 Options). At least an additional 6,694,775 PA Options had been exercised by other option holders, leaving no more than 470,394 of the PA Options unexercised. Once shares had been issued on exercise of these options, the fully diluted capital of Pinnacle would include 53,915,611 Pinnacle Shares, of which Federation would hold 21%.

Federation's Application

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17. Federation has applied to the Panel under section 656A for review of ASIC's Decision. Federation has requested that the Panel vary ASIC's Decision or set it aside and make a decision in substitution to exempt unconditionally from the prohibition in section 606(1) acquisitions of Pinnacle Shares by Federation which result from the exercise of Options acquired by Federation under its takeover offers for Pinnacle.
18. Federation submitted that ASIC's decision should be varied or set aside and that the unconditional relief which it originally requested should be granted. In support of its application, Federation submitted the following:
 - (a) The acquisitions which result from the conversion of the Options do not offend the purposes of Chapter 6, as set out in section 602 of the Law. There is therefore no good reason why the Law does not exempt from the prohibition in section 606 of the Law acquisitions which result from the conversion of convertible securities acquired under takeover offers where unconditional offers are made at the same time for all of the voting shares in the target on terms no less favorable.
 - (b) The market and holders of Pinnacle Shares or Options would have assumed that Federation was considering and would, if circumstances made it desirable to do so, be able to exercise any Options it acquired under its takeover bids. Accordingly, there was no need for Federation to identify in its Bidder's Statements or otherwise that it may exercise the Options or that it may need to apply for the relief, particularly as the need for relief was dependent on the outcome of the bids.
 - (c) Under its bids, Federation did not offer any benefit to the holders of Options that was disproportionate to that offered to the holders of Pinnacle Shares.
 - (d) The exemption requested by Federation is analogous to the statutory exemption from section 606 contained in section 611, Item 3 of the Law.

The issue

19. The issue to be examined in these proceedings is what policy should govern the grant or refusal of this relief (with or without conditions) and in particular:
 - (a) whether it would be consistent with the purposes of Chapter 6 of the Law, as set out in section 602, or any other relevant policy or principle, to grant the relief requested by Federation in its application to ASIC dated 16 January 2001;

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- (b) whether the policy behind the statutory exception to section 606 contained in Item 3 of section 611 of the Law would allow the relief requested by Federation in its application to ASIC dated 16 January 2001; and
- (c) whether either or both of the conditions in the ASIC Instrument, or any other conditions would bring the relief within a policy mentioned in paragraph (i) or (ii) above.

The Law

- 20. Section 606(1) of the Law prohibits a person from acquiring 20% or more of the voting power in a company.⁷ There are a number of exceptions to this,⁸ including where the acquisition fits one of the descriptions listed in section 611 of the Law.
- 21. Item 3 of section 611 of the Law is one such exception. Item 3 provides that acquisitions of relevant interests in a company's voting shares are exempt from the prohibition in subsection 606(1) where the acquisition is of bid class securities and results directly from the exercise of rights attached to convertible securities (which includes options to subscribe) if:
 - (a) the acquisition is by or on behalf of the bidder under a takeover bid;
 - (b) the bidder acquired a relevant interest in the convertible securities through an on-market transaction during the bid period;
 - (c) the bid is for all the voting shares in the bid class; and
 - (d) the bid is:
 - (i) unconditional; or
 - (ii) conditional only on the happening of an event referred to in subsection 652C(1) or (2) (the prescribed occurrences).

ASIC's Draft Policy

- 22. In its submissions, ASIC drew our attention to an unpublished draft ASIC Policy Statement which addresses the issues raised in Federation's application (the *Draft Policy*). We note that this document is in draft

⁷ Under the UK City Code on Takeovers and Mergers, acquisitions of shares resulting from the exercise of options can trigger the obligation to make a mandatory bid. Such acquisitions are also taken into account for the purposes of Rule 5.2, which permits gradual acquisitions. (See City Code Rules 5.1, 5.2 and 9, and Rule 1 of the Rules Governing Substantial Acquisition of Shares.)

⁸ See, for instance, section 611 of the Law. For example, Item 1 of section 611 exempts acquisitions that result from the acceptance of an offer under a takeover bid from prohibitions in section 606.

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form and has not been published or adopted by ASIC. ASIC is therefore not bound by the document in any way. Federation was not aware of, and did not rely on, the Draft Policy.

The requirements of Item 3 of section 611 and the Draft Policy

23. Federation submitted that ASIC should have granted the exemption it requested as it was analogous to the exception contained in Item 3 of section 611. ASIC submitted that Federation should not be granted an exemption as it had not complied with the requirements of the Draft Policy.
24. With these submissions in mind, we considered the requirements of Item 3 of section 611 and the Draft Policy, and the extent to which Federation met these requirements. The following table documents our analysis of the facts in this regard.

| Requirements of Item 3 of Section 611. | Application to the facts |
|---|---|
| The acquisition of shares must result directly from the exercise of rights attached to convertible securities. Options are convertible securities. | This element is satisfied. The acquisition results from the exercise of rights attached to the Options. It is a direct result, in that it does not depend on tracing interests through an intermediate company. |
| The acquisition must be by or on behalf of a bidder under a takeover bid. ⁹ | This element is satisfied. The acquisition is by Federation which was the bidder under a takeover bid. The bid had closed at the time the rights were exercised. |
| The bidder must have acquired a relevant interest in the convertible securities by an on-market transaction during the bid period. 'On-market transaction' means a transaction on the stock market of a securities exchange which is an on-market transaction within the meaning of the rules of the exchange or effected in the ordinary course of trading on the exchange. In effect, this requires that: (a) the convertibles are quoted; | This element is not fully satisfied. The Options were acquired off-market, by acceptance of offers under takeover bids for the Options. The Options were quoted on the ASX at the relevant time. The bidder acquired a relevant interest in the Options during the bid period. The Options were not acquired for cash. See paragraphs 25 to 27 below for a discussion of the policy relating to this requirement. |

⁹ There does not appear to be any requirement that the bid must still be open when the rights are exercised.

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| <p>(b) they be acquired for cash;</p> <p>(c) the Business Rules apply to the trade; and</p> <p>(d) the trade occurs in an anonymous market.</p> | |
| <p>The bid must have been for all the voting shares in the bid class.</p> | <p>This element is satisfied.</p> <p>It was a full bid for the Pinnacle Shares <u>and</u> for the Options.</p> |
| <p>The bid must have been unconditional, or conditional only on prescribed occurrences.</p> | <p>This element is satisfied.</p> <p>While the bid was initially conditional upon acceptances, it was declared unconditional 2 weeks after the offers were made.</p> |
| <p>Requirements of ASIC’s draft Policy Statement.</p> | <p>Application to the facts</p> |
| <p>The convertible securities were acquired during a takeover bid for all shares in the target.</p> | <p>This element is satisfied.</p> |
| <p>The convertible securities are acquired under a takeover bid for all the convertible securities on issue by the target.</p> | <p>This element is satisfied.</p> |
| <p>The bid for shares must have been unconditional, in that any conditions must have been waived or satisfied at close.</p> <p>This appears to require only that section 650G not be triggered by a defeating condition.</p> | <p>This element is satisfied.</p> <p>The conditions in Federation’s bids were all waived on 18 October 2000.</p> |
| <p>The bidder’s statement must have set out either existing relief to allow the acquisition on conversion or the bidder’s intention to apply for that relief.</p> | <p>This element is not satisfied.</p> <p>The Bidder’s Statement says nothing on the point. On the evidence presented to us, Federation said nothing directly on point in any other public document.</p> <p>See paragraphs 28 to 33 below for a discussion of the policy in relation to this requirement.</p> |
| <p>Except in unusual circumstances, the relief will not be granted after the service of the bidder’s statement.</p> <p>The Policy Statement indicates that this is not an essential element.</p> | <p>This element is not satisfied.</p> <p>See paragraph 28 to 33 below for a discussion of the policy in relation to this requirement.</p> |
| <p>ASIC must be satisfied that the bidder is not offering a disproportionate benefit to holders of the convertible securities.</p> | <p>This element is not satisfied, because ASIC did not make a determination on this issue.</p> <p>See paragraphs 34 to 37 below for a</p> |

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| | further analysis of the facts in this case. |
| <p>The consideration under the relevant bids must consist of cash only.</p> <p>Again, the Policy Statement indicates that this is not an essential element.</p> | <p>This element is not satisfied.</p> <p>The consideration was quoted securities (i.e. shares in Federation).</p> <p>See paragraphs 38 to 39 below for a discussion of the policy in relation to this.</p> |
| <p>The consideration for the options must be only the value of the option in the event of immediate exercise and acceptance of the bid and must not reflect the time value of the option.</p> <p>In effect, the difference between the price offered for the shares and the price offered for the options must be equal to the exercise price of the options.</p> <p>Again, the Policy Statement indicates that this is not an essential element.</p> | <p>Based on the prices provided to us in Federation’s application to the Panel, this element is roughly satisfied.</p> <p>The exercise price of the Options is 20 cents, the value of the bid for the Options was 39 cents and the value of the bid for the Pinnacle Shares was 56.7 cents, a difference of 17.7 cents. See paragraphs 34 to 37 for a further analysis of these facts.</p> |
| <p>Relief only applies to options which are exercised within 2 months of the close of the bid.</p> | <p>This element is satisfied.</p> <p>The bids closed on 29 December 2000 and the Options were exercised by 1 February 2001.</p> |

25. Some of the elements of Item 3 section 611 and the draft Policy were not satisfied by Federation’s bids. To determine the significance of this, we looked at the policy behind each of the requirements that were not met in Federation’s case.

The acquisition should have been made on market.

26. The policy of this requirement of Item 3 of section 611 would appear to be to ensure that all option-holders have reasonable and equal opportunities to sell to the bidder and that the prices the bidder pays be set in the open market or at least be comparable with market prices.
27. That policy is adequately fulfilled on this occasion, as the Options are quoted (so there is a market price for them) and holders had better opportunities to sell at Federation’s price than they would have done, had Federation merely bought Options on market, without giving notice or standing in the market. In addition, as the Options are quoted, it is likely that the holdings would be relatively widely distributed, therefore decreasing the likelihood that the bidder is targeting specific shareholders who are likely to be primary beneficiaries of the offers in relation to the Options.
28. A full bid under Chapter 6 is at least as well regulated, transparent and equitable as on-market trading under the Business Rules.

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The need to inform of an intention to exercise securities and to apply for ASIC relief

29. The Bidder's Statement did not disclose an existing exemption to exercise the Options or an intention to apply for such an exemption, and in fact no application was made until after the bid closed.
30. The policy of these requirements of the Draft Policy appears to be that the market and shareholders in the target in particular should be warned of the offeror's intentions regarding exercise of the options.
31. If the bid had been conditional on satisfying the requirements for compulsory acquisition, the offeror's intentions concerning exercise of the options would then have been of academic interest only, being more relevant to the funding of a subsidiary than to control of a listed company. No exemption would have been required to exercise the Options, had Federation received acceptances for 90% of the Pinnacle Shares.
32. Federation's bid was, however, only conditional upon receiving 30% acceptances, and the bid was made unconditional just over 2 weeks after offers were made. With the benefit of hindsight, Federation should have disclosed its intentions regarding the Options if not at the outset, then at least when it waived the minimum acceptance condition, because it then accepted in effect that it might hold considerably less than 100% of Pinnacle after the bid.
33. However, in our view, the facts that the Options were "in the money" at the time of the offer and that the expiry date of the PA Options was close, we accepted Federation's argument that the market would have assumed that Federation bought the Options intending to exercise them when and as it could, for the purpose of increasing its control over Pinnacle.
34. It is also relevant to note that the draft ASIC Policy Statement was unpublished, so it is reasonable to assume that Federation (or any other bidder) was unaware of ASIC's policy requirements in this respect.

The bidder must not offer a disproportionate benefit to the holders of convertible securities

35. The closing prices on the date that Federation announced the bids and the value of the bids using those prices were:

| Closing Price | Ratio | Bid Price | Premium to Market |
|---------------|-------|-----------|-------------------|
| | | | |

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|-----------------------|--------|----------|-------|-------|
| Federation Shares | \$3.12 | | | |
| Pinnacle Shares (PS) | 57¢ | 2 for 11 | 56.7¢ | -0.3¢ |
| Pinnacle Options (PO) | 38¢ | 1 for 8 | 39¢ | +1.0¢ |
| PS – PO | 19¢ | | 17.7¢ | |

36. Federation submitted that the 1:8 consideration for the Options was the round number which came nearest to matching the market price of the Options. ASIC submitted that Federation could have used a simple cash adjustment to negate any discrepancies between the value of the bids for options and the Pinnacle Shares. Federation’s response to this was that the additional administrative burden and expense which would have been involved in dispatching an additional form of consideration to each offeree who accepted the offer meant that a cash adjustment was not a realistic alternative.
37. We consider that the consideration offered by Federation for the Pinnacle Options was not disproportionate to the consideration it offered for the Pinnacle Shares.
38. The exercise price of the Options is 20 cents. The difference between the considerations offered for the Pinnacle Shares (56.7 cents) and the Options (39 cents) is 17.7 cents. That differential favours the options by 2.3 cents. Compared to market prices, however, the Options are favoured by only 1.3 cents: Federation offered 0.3 cents under market for the Pinnacle Shares, one cent over market for the Options.

The consideration under the bids must be cash

39. The intention of the Draft Policy in requiring the bid consideration to be cash is probably to ensure that prices for different securities can be compared with precision. This policy is largely satisfied in Federation’s case.
40. Federation offered shares in itself for both the Shares and the Options. Since those shares are quoted, the value of the consideration can be ascertained with reasonable precision. Since the same securities were offered for the different classes of securities in Pinnacle, the considerations can be compared precisely.

The Otter Gold case

41. In its submissions, ASIC stated that it determined Federation’s application in accordance with the principles espoused in the Draft Policy and established during the consideration of previous applications and the case of *Re Otter Gold NL and Australian Securities Commission and Another* (1997) 15 ACLC 387 (*Otter Gold*).

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42. The AAT in *Otter Gold* upheld the Commission’s decision to grant a conditional exemption to Beaconsfield from compliance with section 615 of the Law, to allow it to exercise all the options which it had acquired under a takeover offer for Allstate Explorations NL. The AAT only upheld the Commission’s decision because of the applicant’s delay. Had the application been made in time, the AAT would have reversed the Commission’s decision, for the following reasons:

- (a) In its Part A Statement, Beaconsfield stated that it intended to exercise all the options it acquired under the offer. Following a challenge to the validity of this statement of intentions in the Supreme Court of New South Wales¹⁰, Beaconsfield issued a supplementary document which stated that it would exercise up to the same percentage of the options as its percentage entitlement to the shares,¹¹ and that it would sell the excess shares if it was unable to find a legal way to exercise any excess options (such as by obtaining shareholder approval).

After the close of its offer, Beaconsfield announced that it would sell down its excess shares. However, it then applied to the ASC for an exemption to enable it to retain and exercise all of the options. The ASC granted that exemption, on the basis that Beaconsfield would treat the shares acquired in excess of its percentage entitlement as if they were acquired under section 618.¹² The AAT rightly stressed that the market needs reliable information about intentions, and held that Beaconsfield had misinformed the market about its intentions.

- (b) Voting power in Allstate was finely balanced, and the relief gave Beaconsfield an increased percentage.
- (c) There was no ASC policy supporting the grant of relief and it was contrary to the Eggleston principles.
- (d) An interpretation clause in the instrument, referred to as ‘the rider’ gave Beaconsfield an unjustified advantage.

¹⁰ *Allstate Explorations NL v Beaconsfield Gold NL* (1996) 14 ACLC 973. In this case, McLelland CJ in Eq held that a statement that Beaconsfield would exercise the options was materially misleading “in that it implies that Beaconsfield Gold may lawfully exercise the acquired options without qualification” (at 976). However, in directing Beaconsfield to issue a supplementary document to correct its Part A statement, his Honour had been more concerned with information about whether Allstate would receive the exercise money for the options rather than with information about control of Allstate.

¹¹ For instance, if Beaconsfield was entitled to 30% of the shares, it would exercise up to 30% of the options on issue.

¹² Now Item 9 of section 611: the 3% creep rule.

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43. We consider that the circumstances in Federation's case can be distinguished from *Otter Gold* for the following reasons:
- (a) Unlike Beaconsfield, Federation made no misleading announcements concerning its intentions. Indeed, on the evidence presented to us, Federation did not make any announcements about its intentions in relation to the Options.
 - (b) Voting power in Pinnacle is not finely balanced as it was in Allstate. Based on the number of Options exercised by 2 February 2001, Federation's voting power in Pinnacle was 21%. While Reliable has, since the close of Federation's bid, announced its own bid for Pinnacle, that bid is conditional on a minimum acceptance of 51% of the Pinnacle Shares. The fact that Federation holds an additional 1% of the voting power in Pinnacle will not materially affect Reliable's prospects of success in its bid or affect its control of Pinnacle, if its bid succeeds.
 - (c) We consider that there always was a legislative policy supporting the grant of relief, and this has been extended since *Otter Gold* was decided. Our reasons for this view are explained in greater detail in paragraphs 44 to 55 below.
 - (d) There is nothing in this case corresponding with the 'rider' in *Otter Gold*.

Policy of Item 3 of section 611 and the Eggleston principles

44. The predecessors of Item 3 of section 611 are previous section 627 of the Corporations Law and paragraph 12(h) of the *Companies (Acquisition of Shares) Act 1980 (CASA)*, which was similar in terms to section 627. There is no guidance in secondary materials on what the legislature intended these provisions to do. The explanatory memoranda for and second reading speeches for all three provisions are unhelpful. ASIC has published no relevant policy. NCSC Practice Notes 304 and 311 mention paragraph 12(h), without discussing its policy.
45. In its *Report on Anomalies in the Takeovers Provisions of the Corporations Law*,¹³ the Legal Committee of the Companies and Securities Advisory Committee pointed out a potential drafting weakness in section 627, which was remedied in Item 3: section 627 required the options to be acquired at a time when shares could be bought on market, but did not expressly require the options to have been bought on market (although, arguably, it did imply this). However, CASAC did not

¹³ March 1994

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discuss the policy of section 627 in depth. The primary change in the law from section 627 to Item 3 of section 611 was to widen the scope of the provision to cover all convertible securities and not just renounceable options, options or rights.

46. In addition to *Otter Gold*, the only other decision relating to the application of these provisions is *Green v Crusader Oil NL* (1985) 4 ACLC 118 (*Green's case*), a decision of Young J of the Supreme Court of New South Wales on paragraph 12(h) of CASA.
47. While *Green's case* gives no assistance with the policy of the exemption, it illustrates a possible abuse of it. The bidder in that case did not stand in the market to buy options. It bought the relevant options from an associate on market, allegedly pursuant to a prearranged transaction.

Applying the legislative policy

48. Unless additional requirements are applied by the Panel as a matter of policy, Item 3 (and each of its predecessors) allows a person who has made a bid for all the voting shares in the bid class to increase its entitlement by any amount, at any time during the bid period, and without any warning. While the options must be bought on market in the ordinary course of trading during the bid, there is no requirement to stand in the market for any period of time, and the buying can be highly selective in effect. In addition, there is no requirement that there be any consistency in the prices the bidder pays for options or any proportionality between those prices and the price offered by the bidder for shares. The contrast with the Eggleston principles is stark.¹⁴
49. The AAT in *Otter Gold* did not look at these consequences of the section. Instead, they turned directly to consider the exemption in the light of the Eggleston principles now in section 602 of the Law.
50. In *Otter Gold*, it seems to have weighed with the AAT that there was no ASC policy to sustain the grant of the exemption to allow Beaconsfield to exercise the options it acquired as a result of its bid for Allstate. While the AAT mentioned the policy of section 627, it did not consider how far the ASC was entitled to rely on that policy:

‘The ASC also took into account that, under the provisions of section 627 of the Corporations Law, an offeror can purchase options on market and exercise them (subject to an exemption [sic] not relevant here). Section 627 of the Corporations Law evidences a policy to enable an offeror, who is making a full

¹⁴ We note, however, that an abuse of Item 3 could form the basis of a claim of unacceptable circumstances and be brought before the Panel.

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bid for shares in a company, to acquire all other rights which might otherwise dilute the effect of the takeover offer.¹⁵

51. This is a curiously narrow description of the effect of section 627. The exception given by that section allowed a bidder to acquire shares pursuant to the exercise of options (and not just to acquire the options themselves), without any limitation to merely maintain its percentage entitlement.
52. Item 3 stands for a limb of the legislative policy behind Chapter 6. That limb is probably that a person making a full and unconditional bid for a class of shares should be able to acquire the other equity in the target company. However, the provision in its original form (as paragraph 12(h) of CASA) neither carried that policy to completion (by allowing compulsory acquisition of options) nor regulated the manner of acquisition of the options and its relation to the bid for shares.
53. The exception dates from a time before bids for companies with complex capital structures were facilitated by:
 - (a) the reinstatement of takeovers by members' schemes of arrangement;¹⁶
 - (b) the emergence of the technique of compulsorily acquiring options under creditors' schemes of arrangement;¹⁷
 - (c) Commission exemptions to enable parallel bids to be made for different classes of securities;¹⁸ and
 - (d) Compulsory acquisition of options following a bid for the options;¹⁹
 - (e) Compulsory acquisition of options by a 90% holder²⁰ or 100% holder.²¹

Nevertheless, the Panel is of the view that it should support the appropriate use of the exception, in the absence of any of the abuses of it.²²

¹⁵ *Re Otter Gold NL and Australian Securities Commission and Another* (1997) 15 ACLC 387 at 393

¹⁶ See paragraph 12(ea) of CASA (which was inserted into CASA by the *Companies (Acquisition of Shares) Amendment Act 1981*), old section 625 of the Corporations Law and current item 17 of section 611.

¹⁷ See *Re BDC Investments Ltd (No 2)* (1988) 13 ACLR 201; *Re Austamax Resources Ltd* (1985) 10 ACLR 194; *Re Asia Oil and Minerals Ltd* (1986) 5 NSWLR 42 and *Re US Masters Ltd* (1990) 4 ACSR 462.

¹⁸ NCSC Policy Statement 160.

¹⁹ See the new section 661A of the Law, and also *Australian Securities and Investments Commission v DB Management Pty Ltd* (2000) 199 CLR 321.

²⁰ Section 664A of the Law.

²¹ Section 665A of the Law.

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54. From this point of view, the fact that the Law now facilitates bids for securities other than shares and parallel bids for different classes of securities represents a continuation and development of the policy for which Item 3 stands. Unfortunately, the new provisions have not been related to Item 3 to build a totally comprehensive regime for the acquisition of the whole of the equity in a target company.
55. Accordingly, there is force in Federation's argument that Chapter 6 currently discriminates inappropriately against a bidder which makes a full takeover bid for options in parallel with a bid for shares, instead of merely buying some options on market during its bid for shares. Such a bidder bids for options in the way now favoured by Chapter 6, gives all option-holders reasonable and equal opportunities to sell into the bid at the same price and excludes the selective dealing seen in *Green's case*.

Applying the policy to the facts

56. We have mentioned that Item 3 could be abused in ways which may lead to relief being withheld and perhaps even to a declaration of unacceptable circumstances. In our view, none of these mischiefs are present in these facts, except that Federation did not adequately disclose its intentions in relation to the Options.
57. The price Federation paid for the Options is reasonably proportionate to the price for the Pinnacle Shares, whether we are guided by market prices or by the exercise price for the Options.
58. The number of Options exercised is moderate, taking Federation's voting power in Pinnacle to just over 20%. While the proportion of the PA Options bought by Federation under its bid (49%) is high compared to the number of shares bought under the bid for shares (10%), that does not imply that the bid for the shares was in any sense a sham. It is adequately explained by the bid providing PA Option holders with an easy way to convert their Options to equity, which would otherwise have needed to be exercised for cash consideration.
59. There is nothing unacceptable about the circumstances surrounding Federation's exercise of the options, however, unless it is the combined effect of the facts that:
- (a) it did not explicitly declare its intention in relation to the Options; and
 - (b) it did not seek relief to exercise them until a month after the close of the bid.

²² Refer to paragraph 48 above.

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60. When Federation offered to acquire the options they were well “in the money”, it was not long before their expiry, and Federation made a full bid and said nothing misleading about its intentions.
61. The Draft Policy appropriately requires that a bidder notify shareholders and the market of its intentions in relation to the exercise of options purchased under a takeover bid, and that a bidder seek relief to exercise options immediately after they are acquired. This is sensible policy, but it would be unfair to impose it on Federation retrospectively. Federation could not reasonably be expected to have known that these requirements existed when Federation made its bids or when it declared the bids unconditional. It is unlikely that Pinnacle shareholders misunderstood Federation’s intentions; although they may have wondered whether it would exercise the options if the bid was partially successful.
62. For this reason, we have decided to vary the ASIC Instrument by removing the conditions, which has the effect of granting Federation an unconditional exemption from the prohibition in section 606 in respect of the acquisition of Pinnacle Shares as a result of the exercise of the Options acquired by Federation under its takeover bids.

Policy to be followed

63. While we have been guided by legislative policy in our consideration of this application, our decision is ultimately based on the particular facts surrounding this case.
64. For the benefit of the market and future bidders, some guidance is required as to the policy to be applied where a bidder wishes to exercise options acquired under a bid in the future. While the Draft Policy provides a sound starting point in this regard, we emphasise that it has not been published or formally adopted by ASIC. While ASIC has no formal stance on this issue, some guidance can be obtained from what falls out of the considerations set out above.
65. The intention of Parliament is that a bidder should be able to exercise options (and other convertible securities) if:
 - (a) the options are acquired by a bidder;
 - (b) they are acquired during a full bid for shares which is unconditional or conditional only on prescribed occurrences;
 - (c) they are acquired on market in the ordinary course of trading.
66. In relying on Item 3, bidders need to avoid abusing it. The following are suggestions, but not a code:

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- (a) on-market buying should not be selective;
- (b) the prices paid for options should be consistent (but can be increased, like prices under a bid for shares);
- (c) the prices paid for options should be equitably related to the prices paid for shares under the bid (taking into account the exercise price of the options);
- (d) the bid for the shares needs to have a cash price or alternative;
- (e) the bidder should promptly announce its intentions regarding exercise of the options; and
- (f) exercise of the options should not be unduly deferred.

However, even if all of these suggestions are followed, an acquisition in reliance on Item 3 may take place in unacceptable circumstances, in the light of section 602.

67. We would support ASIC in developing policy which extends this legislative policy to comparable cases, at least case by case. That policy might appropriately extend to options acquired off-market under a takeover bid (or comparable general offer). The consideration for the options should be directly comparable with and proportional to the consideration (or an alternative) offered for the shares. ASIC could reasonably publish a requirement that the bidder's intentions regarding exercise of the options be promptly announced, and the relief to exercise the options be sought promptly after they are acquired. ASIC should retain the discretion to refuse relief where the policy of the exemption would be abused.

Les Taylor
President of the Sitting Panel
Decision dated 8 February 2001
Reasons published 22 February 2001