

In the matter of Namakwa Diamond Company NL (No. 4)
[2001] ATP 15

Catchwords:

Review of Panel decision – independent expert’s report – allegation of deficiencies in valuation – valuation methodology – equality of treatment – reliance on incomplete or hypothetical data in preparing expert’s report – distinction between matters of fact and opinion – insufficient evidence to commence proceedings

Corporations Law (Cth), sections 638 and 765

Australian Securities and Investments Commission Regulations, r 20

On 27 May 2001, following a review of the decision of the Corporations and Securities Panel in relation to Namakwa Diamond Company NL No. 3, we decided that we had received insufficient evidence supporting the application by Majestic to commence proceedings on its allegations of deficiencies in the valuation of Namakwa in the independent expert’s report prepared by Ernst & Young Corporate Finance Pty Ltd which accompanied the target’s statement issued by Namakwa on 23 April 2001.

These are our reasons for that decision.

1. The sitting Panel in this matter comprises Simon McKeon (President), Ian Ramsay (sitting Deputy President) and Elizabeth Alexander.
2. This was an application made by Majestic under section 657EA of the Corporations Law (the *Law*) for a review of the Panel's decision in Namakwa Diamond Company No. 3 (*Namakwa 3*). The sitting Panel in Namakwa 3 declined to commence proceedings in relation to allegations by Majestic Resources NL (*Majestic*) that there were deficiencies in the valuation of Namakwa Diamond Company NL (*Namakwa*) in the independent expert’s report (*E&Y Report*) prepared by Ernst & Young Corporate Finance Pty Ltd (*Ernst & Young*) which accompanied the target’s statement issued by Namakwa on 23 April 2001.
3. These are our reasons for coming to the same decision as the sitting Panel in Namakwa 3, under Regulation 20 of the ASIC Regulations, to decline to commence proceedings in relation to Majestic’s application made on 15 May 2001 for a review of the sitting Panel’s decision in Namakwa 3.
4. In reaching our decision we have had the benefit of:
 - (a) Majestic’s application in Namakwa 3;
 - (b) the sitting Panel’s reasons in Namakwa 3;

Corporations & Securities Panel

Reasons for Decision – Namakwa Diamond Company NL (No. 04)

- (c) the material documents from the Panel in Namakwa Diamond Company NL No. 2 (*Namakwa 2*); and
- (d) Majestic's application for review of the decision of the sitting Panel in Namakwa 3.

Majestic's application

5. Majestic alleged that the sitting Panel in Namakwa 3 had been inconsistent and unequal in its treatment of Majestic's application in Namakwa 3 compared to the decision of the Panel in Namakwa 2. In its application for review of the decision in Namakwa 3, Majestic:
 - (a) alleges that the valuation methodology used by Ernst & Young in the E&Y Report gives rise to a potential for Namakwa shareholders to be misled into believing their shares have a value far in excess of their true worth;
 - (b) alleges that the Namakwa 3 sitting Panel's dismissal of the Namakwa 3 application contrasts sharply with its treatment of Namakwa's complaints in Namakwa 2 of similar statements by Majestic in its bidder's statement regarding the value of Majestic's existing and future projects; and
 - (c) requests the Panel to afford Majestic equality of treatment in relation to the issues it raised in Namakwa 3 in relation to the E&Y Report.
6. The sitting Panel in Namakwa 2 had required Majestic to make substantial additional disclosures in response to Namakwa's complaints concerning disclosures made by Majestic in its bidder's statement. However, the sitting Panel in Namakwa 3 declined to commence proceedings concerning Majestic's allegations of inaccuracies in Ernst & Young's valuation of Namakwa.
7. Majestic stated in its review application that its only available recourse is to address any deficiencies and inaccuracies in Namakwa's target's statement and the E&Y Report by issuing a further supplementary bidder's statement. Majestic alleged that such a self-help remedy is inappropriate and ineffective in the context of a fiercely contested takeover bid especially when the Panel had required it to issue a supplementary bidder's statement following the Panel's decision in Namakwa 2.¹
8. Majestic further claimed that in light of the decision of the Panel in Namakwa 2, statements issued by Majestic in an attempt to correct errors in the E&Y Report would not carry the same weight as they would if backed by a direction from the Panel. Accordingly, Majestic alleged that there is potential for Namakwa's unsophisticated shareholders to be misled by attaching undue weight to the E&Y Report, particularly given that it was prepared by a large accounting firm such as Ernst & Young.

¹ See the Panel's decision in Namakwa 2 dated 15 May 2001.

Corporations & Securities Panel

Reasons for Decision – Namakwa Diamond Company NL (No. 04)

Sitting Panel's decision in Namakwa 3

9. We came to the same decision as the sitting Panel in Namakwa 3, namely that the issues raised by Majestic in its application in relation to Namakwa 3 are matters of opinion which Majestic may appropriately raise in a supplementary bidder's statement in response to Namakwa's target's statement
10. We have not seen any material evidence that the sitting Panel's consideration of, and its decision in relation to, Majestic's application in Namakwa 3 was inconsistent with the Panel's treatment of Namakwa's complaints in Namakwa 2, nor that it constituted unequal treatment of Majestic's complaint in Namakwa 3 as compared with Namakwa's complaints in Namakwa 2.

Considerations

11. We consider that the matters raised by Namakwa in its application in Namakwa 2 in respect of Majestic's bidder's statement were matters of fact capable of objective determination and which it was therefore appropriate for the sitting Panel in Namakwa 2 to require Majestic to correct and clarify. These included, for example:²
 - (a) Misstatement of the known likely total resources that would be available to the combined Majestic/Namakwa group;
 - (b) Statements that were materially different from the terminology required under the JORC Code; and
 - (c) Lack of adequate disclosure of the assumptions underlying Majestic's pro forma unaudited balance sheet that was included in the bidder's statement.
12. In addition, in Namakwa 2 the sitting Panel expressly acknowledged that there were additional matters raised by Namakwa in its application in respect of disclosures in Majestic's bidder's statement which were not issues of fact and which fit the nature of the issues raised in Namakwa 3 and Namakwa 4. The sitting Panel at paragraph 30 of the reasons for decision said:

"We also considered that these were largely matters of opinion or judgement, on which it would be appropriate for Namakwa to comment in its target's statement."
13. We consider that a distinction can be made between:
 - (a) substantive factual matters complained of by Namakwa in Namakwa 2 (for example, volume of resources available to the merged group and percentage premium that the offer represents); and
 - (b) matters of opinion capable of rebuttal such as:

² See generally paragraphs 8 to 29 of the sitting Panel's decision in Namakwa 2.

Corporations & Securities Panel

Reasons for Decision – Namakwa Diamond Company NL (No. 04)

- (i) those raised by Majestic in Namakwa 3 concerning the basis of Ernst & Young's valuation of Namakwa; and
 - (ii) Namakwa's complaints in Namakwa 2 concerning Majestic's statements regarding potential market interest in Majestic and liquidity and Majestic's marketing network and relationships.
14. At any stage during the bid period it was open to Majestic, if Majestic considered it appropriate and to its advantage, to engage an expert to undertake an independent valuation of Namakwa's assets and shares and issue that report to offerees with a supplementary bidder's statement. In this way it was open to Majestic to rebut Ernst & Young's opinions and assumptions set out in the E&Y Report with a report from an equally credible expert. Majestic did not avail itself of that opportunity.
15. In preparing its report, Ernst & Young relied on the independent geological report on the Namakwa Diamond Project (*Snowden Report*) prepared by Snowden Mining Industry Consultants Pty Ltd (*Snowden*) and subsequent discussions Ernst & Young had with Snowden. This is referred to by Ernst & Young in the E&Y Report.³ We note that, because the Namakwa Diamond Project is in its very early stages of exploration and evaluation, the Snowden Report provided Ernst & Young with a very limited amount of information concerning Namakwa's prospects on which Ernst & Young could base the E&Y Report. This also caused Ernst & Young to make the large number of assumptions in the E&Y Report, which Majestic complained of in its application.
16. The Snowden Report contains a more detailed assessment of the risks associated with the prospects of the Namakwa Diamond Project and was sent to prospective investors with Namakwa's prospectus. We note that Namakwa's prospectus was not sent to Namakwa's shareholders with either the bidder's statement or the target's statement. In its target's statement, Namakwa could have offered its shareholders the option to request a copy of the prospectus should they have wished to consult it or the Snowden Report. This approach would be consistent with the policy underlying section 712 of the Law (which applies to bidder's statements where a scrip offer is made, but does not apply to target's statements).⁴ Namakwa's prospectus was lodged with ASIC on 15 December 2000. Namakwa's shares commenced trading on the ASX on 15 March 2001 and on the same day Majestic announced its takeover bid. It is likely that the vast majority of Namakwa's shareholders who received the bidder's and target's statements would have received a copy of the prospectus in December 2000.

³ See paragraph 6 of page 3, paragraph 5 of page 6 and paragraph 6 of page 12 of the Report.

⁴ Section 636(g) of the Law requires a bidder to include in its bidder's statement all material that would be required for a prospectus for an offer of securities under sections 710 to 713. Section 712 allows information contained in a document previously lodged with ASIC to be incorporated by reference into the bidder's statement. These provisions do not apply to a target's statement prepared in accordance with section 638.

Corporations & Securities Panel

Reasons for Decision – Namakwa Diamond Company NL (No. 04)

17. With the benefit of the bidder's and target's statements⁵ and the E&Y Report, Namakwa's shareholders should be able to make a reasoned assessment of the merits of Majestic's offer and the uncertainties that Ernst & Young's assumptions brought to the valuation.⁶
18. We consider that an independent expert should take care in the preparation of its report where, in relation to a project, the expert relies on a limited amount of information that is not comprehensive. Where, as a result, an expert relies heavily on assumptions in valuing the project (such as the Namakwa Diamond Project), the expert should ensure that shareholders are reminded of the incomplete or hypothetical nature of the data it has relied upon. This is particularly so where the report relies on documents which are not themselves included with the expert's report. The expert should provide prominent and sufficient words of caution to shareholders by making it clear in its report that the expert's opinion is based on the limited amount of information made available to it.
19. We consider that an independent expert's report prepared to accompany a bidder's or target's statement should be capable of being read as a stand-alone document and that the E&Y Report was satisfactory in this regard.

CONCLUSION

20. We consider that the additional disclosures required of Majestic by the sitting Panel in Namakwa 2 were materially different in nature from the issues raised in the Namakwa 3 and Namakwa 4 applications. We reach the same conclusion as the sitting Panel reached in Namakwa 3 that proceedings should not be conducted on the basis that the matters raised in Majestic's review application are matters of opinion which are open to rebuttal and discussion by Majestic. We do not consider that Namakwa's shareholders would have been misled by the E&Y Report.

Simon McKeon
President of the Sitting Panel
Decision dated 30 May 2001
Reasons published 25 June 2001

⁵ On page 11 of the target's statement there is a table which specifically outlines a timeline for exploration and evaluation of the Namakwa Diamond Project.

⁶ Section 602(b)(iii) of the Law provides that one of the purposes of the provisions in Chapter 6 of the Law is to ensure that shareholders in a company and interestholders in a scheme and directors of the company or responsible entity for the scheme are given enough information to enable them to assess the merits of a proposed takeover offer.