Takeovers Panel

Reasons for Decision
AuIron Energy Limited

In the matter of AuIron Energy Limited
[2003] ATP 31

Catchwords:
Shareholder approval of acquisition – notice of meeting – independent expert's report – function of report – dealing with alternative proposals in the report – general meeting – voting procedures
Relevant interest – substantial holding – disregarded relevant interest - nominee holder – bare trust

Corporations Act 2001 (Cth), sections 608(1), 608(8), 609(2), 611 item 7, 671B

ASIC Policy Statement 74 'Acquisitions agreed to by shareholders'

Australian Securities Commission v Bank Leumi Le-Israel and others (1995) 18 ACSR 639
Corumo Holdings Pty Ltd v C Itoh Ltd (1991) 5 ACSR 720 NSW CA
Email Limited (No 1) [2000] ATP 5, 18 ACLC 708
Re Glencore Nickel Pty Ltd (2003) 44 ACSR 210
Thorpe v Bristile Ltd (1996) 16 WAR 500

These are our reasons for our decision not to make a declaration of unacceptable circumstances in relation to the affairs of AuIron Energy Ltd on an application by Westchester Financial Services Pty Ltd under section 657C for a declaration of unacceptable circumstances under section 657A and associated orders under sections 657E and 657D.

THE PROCEEDINGS

1. These reasons relate to an application (the **Application**) to the Panel by Westchester Financial Services Pty Ltd (**Westchester**) under section 657C of the *Corporations Act 2001* (Cth) (the **Act**) dated 10 September 2003. The application concerned a general meeting of AuIron Energy Limited (**AuIron)** convened to seek shareholder approval of the acquisition by AuIron of the Yarrabee Coal Company Pty Ltd (**Yarrabee**) in exchange for a substantial interest in AuIron.

THE PANEL & PROCESS

2. The President of the Panel appointed Jeremy Schultz (sitting President), Marian Micalizzi (sitting Deputy President) and Alice McCleary as the sitting Panel (the **Panel**) for the proceedings (the **Proceedings**) arising from the Application.

3. We adopted the Panel's published procedural rules for the purposes of the Proceedings.

SUMMARY

4. Westchester sought a declaration and orders concerning the information provided to a meeting to consider a resolution to approve an acquisition of shares under item 7 of section 611, particularly as regards alternatives to the proposed acquisition. It also contended that unacceptable circumstances had

occurred regarding voting and non-disclosure of shares held by a stockbroker for its clients. We declined the application, as the information provided to AuIron shareholders was not misleading or insufficient for shareholders to make an informed decision on the proposed acquisition of Yarrabee and the broker had not sought to conceal its holdings or manipulate the outcome and the relevant shares, had they been voted in the contrary manner, would not have led to a different result on the relevant resolutions.

FACTUAL BACKGROUND

5. The following summary of the factual background has largely been taken from the Application (including its attachments), submissions from the parties, information provided to the Panel by Williams de Broë plc and KPMG Corporate Finance Pty Ltd (**KPMG**) and announcements to ASX by AuIron.

AuIron

6. AuIron is a company incorporated in Australia and listed on ASX. Its principal activities at all relevant times were exploring for base metals and hydrocarbons in Australia and Northern Ireland. At the time of the application, its market capitalisation was between $16 and $17 million. AuIron's share price has fallen from about 55 cents in January 2002 to about 5 cents at the time of the Application.

7. At the time of the Application, AuIron had also been listed since 2000 on the Alternative Investment Market of the London Stock Exchange (**AIM**). Since 5 May 2003, AuIron's securities had been suspended from trading on the AIM for reasons set out at [34] – [37].

8. Until recently AuIron's most significant assets had been two major resource projects: the South Australian Steel & Energy (**SASE**) project and the Ballymoney project in Northern Ireland.

SASE

9. SASE was a project to develop a new technology to smelt iron ore to pig iron, for which AuIron acquired iron ore and coal tenements and built a demonstration iron smelter in South Australia. On 30 June 2002, AuIron announced that it would cease funding the SASE project as the sole investor and would look for a strategic shareholder to join it, as the project had encountered technical problems that would be too costly for AuIron to fund alone. With the approval of shareholders at a meeting on 28 March 2003, the smelter and associated intellectual property were transferred to a subsidiary of Ausmelt Limited holding world rights to the technology, in which AuIron has a 21.5% revenue interest, convertible into shares if the company is listed.

10. In the 2001/02 Annual Report AuIron made provision for the write-down of the company's investment in the SASE project, comprising capitalised expenditure

on the demonstration iron smelter and capitalised coal and iron ore exploration and evaluation expenditure, totalling $64 million.[1]

Ballymoney

11. The Ballymoney project involved the development of a coal mine in Northern Ireland for power generation. AuIron sought a partner to build an associated power station in Northern Ireland. On 26 June 2003, AuIron announced that in order to make further progress with the development of the Ballymoney Project, AuIron would need to find a major investment partner, that its attempts to find such a partner since 2001 had been unsuccessful and that it would discontinue work on Ballymoney and provide for a write off the capitalised exploration and evaluation expenditure on the project, totalling $14.6 million.[2]

Other assets

12. AuIron's other significant assets were approximately $18.76 million cash (as at 30 June 2003), and various iron ore and coal tenements in South Australia. Assets in Indonesia (including a zeolite resource) were written off in 1999 and disposed of in February 2003, in exchange for a royalty from a gold project.[3] As at 31 December 2002, AuIron had tax losses of $111.8 million.

Williams de Broë plc Shareholding

13. The largest shareholder in AuIron since between April and June 2003 was National Nominees Limited, which held 10.57% of AuIron on behalf of Wilbro Nominees Limited, a wholly owned subsidiary of Williams de Broë plc (together, **Williams**). Prior to this date, Wilbro held the Williams parcel and was the largest shareholder in AuIron. Most of the Williams parcel was held on behalf of clients of Williams.

14. Williams de Broë plc is a member of the London Stock Exchange, involved in carrying on, amongst other things, private client stockbroking and fund management activities.

15. Williams informed us that National Nominees was Williams' Australian custodian, holding for Williams as a bare trustee,[4] and that Williams had decided to move its clients' holdings onto the Australian register after forming the view that it was likely AuIron would lose its AIM listing in London.

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[1] Page 13 of the Directors' Report for 2001-2002 and notes 5, 11 and 12 to the Financial Statements and announcement to ASX on 23 September 2002.

[2] ASX announcement of 26 June 2002 and paragraph 8.39 of the KPMG Report.

[3] According to the KPMG Report discussed below.

[4] Williams assisted the Panel with information on this issue, without becoming a party. Williams de Broë Pty Limited of Sydney is a wholly owned subsidiary of Williams de Broë plc. Neither it nor its employees were involved in the current proceedings.

16. Williams has not lodged a substantial shareholder notice in connection with its shareholding in AuIron. It informed us that the reason was that it did not have a relevant interest in the shares by virtue of section 609(2) ('Nominees and other trustees') of the Act.

The Applicant

17. Westchester had a relevant interest in 1.5% of AuIron's shares. This interest was purchased between 28 January and 7 May 2003.

UK & European Shareholders

18. As at 30 June 2003, approximately 75% of AuIron's shareholders were people whose addresses were in the UK and Europe.

PROPOSED ACQUISITION OF YARRABEE

19. On 5 May 2003, AuIron announced that it had entered into a conditional agreement (**Yarrabee Acquisition**) to acquire Yarrabee from Resource Management & Mining Pty Ltd (**RMM**). Yarrabee's principal asset was the Yarrabee coal mine located in the Bowen Basin in northern Queensland.

20. Under the terms of the Yarrabee Acquisition RMM would receive:

    (a) issued shares equal to 48% of the expanded capital of AuIron; and

    (b) options to acquire AuIron shares at 8.5 ¢ per share exercisable if the volume weighted average price of AuIron shares exceeds 15.5 cents for 10 consecutive days within five years.

    The option formula could be adjusted 'to the extent permitted by the ASX Listing Rules'. If all the options were exercised, RMM's voting power in AuIron would increase to 58%.

21. The Yarrabee Acquisition also involved two directors of RMM joining the board of AuIron, one of them as chairman. The board would also include two of the three directors who held office when the application was made.

Requirement to obtain shareholder approval under Act and ASX Listing Rules

22. The Yarrabee Acquisition was conditional on obtaining several approvals from AuIron shareholders.

23. Shareholder approval of the Yarrabee Acquisition was required under the following provisions of the Act:

    (a) Item 7 of section 611: this provision enables the disinterested shareholders of a company to approve an acquisition of shares or interests which would otherwise be prohibited by section 606. It was required in the present case

because under the terms of the Yarrabee Acquisition, RMM would receive shares in excess of the 20% limit and would also be granted options which, if exercised, would further increase its voting power.

(b) Chapter 2E ('Related party transactions'): this provision enables disinterested shareholders to approve transactions by which a public company gives financial benefits to related parties, including those which are not on arm's length terms. The explanatory memorandum stated that shareholder approval was required under Chapter 2E because of various related party transactions contemplated by the Yarrabee Acquisition, including the possible future exercise of options granted to RMM.

24. Shareholder approval was also required under ASX Listing Rule 7.1 ('*Issues exceeding 15%*') and Listing Rule 11.1.2 ('*Significant change to nature or scale of activities*'). Shareholder approval would also have been required by rule 13 of the AIM rules, which regulates reverse takeover transactions affecting companies listed on AIM.[5]

Notice of Meeting and Independent Expert Report

25. AuIron called a general meeting to be held on 19 September 2003 (**General Meeting**). On 19 August 2003, it sent shareholders a notice of the General Meeting and an explanatory memorandum, together with an independent expert's report prepared by KPMG (**KPMG Report**) and a valuation of AuIron's and Yarrabee's mining interests, prepared by Anderson & Schwab (**A&S**) for KPMG. The KPMG Report concluded, on balance, that the Yarrabee Acquisition was fair and reasonable to the non-associated shareholders of AuIron.

26. The notice of meeting set out eight resolutions to be put to shareholders. Four of these resolutions were required to approve or carry out the Yarrabee Acquisition and the fifth concerned the re-election of an AuIron director. The AuIron directors recommended these five resolutions. The remaining resolutions were requisitioned by Westchester and associated shareholders and opposed by the AuIron directors.

Westchester Candidates and Proposals

27. The sixth and seventh resolutions were to elect Messrs Christopher Ryan and Stephen Blanks as directors of AuIron, on Westchester's nomination. Those resolutions would only be put to shareholders if the Yarrabee Acquisition was rejected by shareholders.

28. Messrs Ryan and Blanks indicated that, if elected, they would seek to change AuIron's strategy, and they proposed various courses of action for AuIron

[5] See the discussion of AuIron's AIM listing at [34] – [37].

(**Westchester Proposals**) as alternatives to the Yarrabee Acquisition. These involved some combination of:

(a) a buyback of 80% of AuIron shares (the second of Westchester's letters to AuIron shareholders indicated that this may not proceed);

(b) a spinoff of the company holding the Ballymoney project;[6] and

(c) unspecified investments in the resources sectors with higher risk/return profiles.

29. Westchester sent two letters dated 16 July and 26 August 2003 to approximately 1500 and 500 respectively of AuIron's largest shareholders, opposing the Yarrabee Acquisition on three grounds:

(a) the Yarrabee mine was a mature asset with little upside potential;

(b) the KPMG Report overvalued the Yarrabee mine and undervalued AuIron's existing assets, in particular the Ballymoney project; and

(c) the dilutive effect of the share issue under the transaction.

They also sought to communicate to other AuIron shareholders via the Westchester website.

Mr Mutton's Candidacy and Proposal

30. The eighth and final resolution to be put to shareholders was to elect as a director of AuIron Mr Ian Mutton, who was General Manager (Legal & Commercial) of AuIron until June 2003. The explanatory memorandum stated that the directors of AuIron opposed Mr Mutton's appointment to the board. They stated their belief that Mr Mutton's main intention for AuIron, to spin off the company holding the Ballymoney Project, was not viable owing to the large risks associated with the Ballymoney Project.

Board Response to Westchester and Mutton Proposals

31. On 24 July, AuIron wrote to its shareholders about the Yarrabee Acquisition. That letter gave brief details of the Westchester Proposals and rejected them as not being in the best interests of AuIron, stating:

> "Mr Ryan and Mr Blanks have not provided any meaningful or comprehensive details how the strategy of pursuing superior returns could be achieved nor whether they have followed this type of investment strategy with success previously".

32. The explanatory memorandum stated that the directors of AuIron opposed the election to the board of Messrs Ryan and Blanks on the grounds on which they

[6] i.e. a distribution of the shares in that company to shareholders in AuIron.

had rejected the Westchester Proposals in July, and because they believed that the Westchester Proposals were not in the best interests of the company.

33. On 3 September, AuIron wrote to its shareholders again about the resolutions for the 19 September general meeting. As well as discussing the Yarrabee Acquisition, the letter briefly mentioned Westchester's and Mr Mutton's proposals and criticised them as being vague and relying on overly optimistic assessments of both the Ballymoney and SASE projects.

Suspension from AIM

34. AuIron was suspended from AIM on 5 May 2003, the day that it announced the Yarrabee Acquisition, under Rule 13 of the AIM rules and the Guidance Note to that rule, which require a company listed on AIM which announces a reverse takeover for a company (not itself listed on LSE or AIM) to provide at the same time information about the merged entity equivalent to an admission document or a prospectus, or to be suspended from trading until that information is provided.

35. The explanatory memorandum informed shareholders that the AuIron board had not yet decided whether to seek re-admission to AIM in the event that the Yarrabee Acquisition took place. It stated that, in deciding whether to seek re-admission to AIM if the Yarrabee Acquisition proceeded, the Board would consider the views of key stakeholders and the advantages and disadvantages of retaining the AIM listing.

36. On 8 September 2003 AuIron made an announcement concerning the AIM listing. It said that:

    (a) the London Stock Exchange had informed AuIron that the explanatory memorandum did not contain the financial information required by the AIM rules; and

    (b) the AuIron directors did not propose to provide shareholders with that information, as they believed that it was not in the best interests of AuIron to seek readmission to AIM, but they were of the view that, after the Yarrabee Acquisition, AuIron would have sufficient working capital to meet its operating requirements.

37. In this announcement, the AuIron directors said that they had decided not to apply for re-admission to AIM if the Yarrabee Acquisition was approved, but that if the Yarrabee Acquisition was not approved, the AIM listing would be retained and they expected the suspension of trading in AuIron's shares on AIM to be lifted.

38. On 11 September, LSE announced that the Explanatory Memorandum did not comply with Rule 13, because it did not contain information equivalent to that

required in an admission document or a prospectus, and that it had fined AuIron 10,000 pounds for the contravention.

APPLICATION

Declaration sought

39. Westchester applied to the Takeovers Panel on 10 September 2003 for a declaration under section 657A of the Act that unacceptable circumstances existed in relation to the affairs of AuIron, and for orders that:

    (a) any votes cast by or at the direction of Williams in relation to the Yarrabee Acquisition be disregarded except to the extent that such votes were cast pursuant to specific authority of the beneficial holders;

    (b) the General Meeting be adjourned to a date not less than 28 days after:

        (i) AuIron disclosed the information required under the rules of the AIM but not contained in the explanatory memorandum;

        (ii) AuIron disclosed the advantages and disadvantages considered by the board in relation to maintaining the listing on AIM; and

        (iii) AuIron disclosed all alternative proposals for AuIron if the Yarrabee Acquisition was not approved, including the advantages and disadvantages considered by the board in relation to each such proposal; and

    (c) AuIron shareholders be provided with a supplementary explanatory memorandum comparing the likely advantages and disadvantages for shareholders if the Yarrabee Acquisition did not proceed with the likely advantages and disadvantages for shareholders if the Yarrabee transaction did proceed, including the advantages and disadvantages associated with retaining the AIM listing.

Insufficient information

40. Westchester submitted that unacceptable circumstances were created by a failure to provide relevant information in the explanatory memorandum and KPMG Report. In particular, the Application stated that the notice of meeting and KPMG Report did not adequately analyse the value of the Yarrabee Acquisition and particularly did not adequately assess the value of AuIron's other assets and the alternatives to the Yarrabee Acquisition.

41. First, Westchester submitted that the KPMG Report was deficient, because it only compared the value of the shares being acquired from RMM to the value of the consideration to be paid (ie the issue of shares and options as described in [20]). It submitted that paragraph 74.21 of ASIC Policy Statement 74 (**PS 74**)

required the independent expert also to consider other factors relating to the Yarrabee Acquisition, including 'the investment of AuIron's cash and the management of AuIron's other assets'.

42. Second, Westchester submitted that the KPMG Report failed to consider alternative courses of action open to AuIron, contrary to paragraphs 74.20, 74.21 and 74.22 of PS 74, in particular the future course(s) of action of AuIron in the event that shareholders did not approve the Yarrabee Acquisition and:

    (a) the company remained in the control of the current board; and

    (b) Messrs Ryan and Blanks were elected as directors and were able to influence the board sufficiently to implement the Westchester Proposals.

43. Westchester submitted that a properly informed market required the report to consider all alternative proposals for a company before making a recommendation in relation to a particular proposal. It submitted that the failure to deal at greater length with the alternatives of business as usual and the Westchester Proposals was contrary to PS 74 and constituted unacceptable circumstances.

Suspension from AIM

44. Westchester submitted that AuIron created unacceptable circumstances by failing to comply with AIM rules and to provide shareholders with:

    (a) the financial data required by the AIM rules;

    (b) the views of key stakeholders on whether the AIM listing should be retained; or

    (c) the cases for and against retaining the AIM listing,

    and that it should be ordered to provide all of this information, in particular that the KPMG Report should address the case for and against delisting from AIM. It submitted that an assessment of the advantages and disadvantages of losing the AIM listing was relevant to consideration of the Yarrabee Acquisition, particularly for the large proportion of AuIron's shareholders who are based in the UK and Europe.

Williams shareholding

45. Westchester contended that unacceptable circumstances resulted from Williams' decision to vote all shares it held on behalf of clients in support of the Yarrabee Acquisition unless directed otherwise, because:

    (a) the business to be conducted at the General Meeting was contentious;

    (b) it alleged that Williams had breached the substantial holding notice provisions of the Act; and

(c) the parcel which would be voted at the direction of Williams is material in determining the outcome of the business to be conducted at the General Meeting.

46. In support of this, it argued that by holding and exercising voting rights in the manner described in [84], Williams had a relevant interest in over 5% of AuIron's issued shares, even if it was not the ultimate beneficial holder of those shares, and that a properly informed market requires nominee holders to operate as bare trustees and not to exercise voting rights, or alternatively that nominee holders with voting rights give substantial holding notices when their holding exceeds 5% of a company's share capital.

Other Submissions

47. We received submissions during the proceedings from Williams, KPMG and several other persons who were not parties for the purposes of Panel procedural rule 3.1. We considered these submissions after circulating them to parties for comment, with the consent of the people who had provided them.

48. Most of these submissions (except those of Williams and KPMG) concerned the value of various of AuIron's assets, in particular the Ballymoney project and some of the Indonesian assets mentioned above. Some submissions requested that we make orders requiring the spinoff of the company holding the Ballymoney project.

Question of interim relief

49. On 15 September 2003 we decided to conduct proceedings in relation to the issues raised in the Application and issued a brief under Regulation 20 of the *Australian Securities & Investment Commission Regulations 2001*.

50. After receiving the undertakings set out below, we decided not to make an interim order requiring the General Meeting to be deferred until additional information was provided to shareholders. The balance of convenience favoured the General Meeting going ahead. If the Yarrabee Acquisition was not approved, the issue of whether more information should be provided would fall away.

51. As we required additional time to consider the substantive submissions we invited and received from AuIron and RMM undertakings to the effect that:

(a) each of the resolutions concerning the Yarrabee Acquisition would be put to a poll;

(b) the Panel's Counsel would be admitted to the meeting as an observer, with access to the people recording and counting votes;

(c) the proxies and the votes on the poll would be recorded and retained and a summary provided to the Panel after the meeting, showing how many

votes were cast, how directed and open proxies were voted and how the shares held by Williams or its nominee were voted; and

(d) if the Yarrabee Acquisition was approved, neither AuIron nor RMM would implement it or withdraw from it without the Panel's approval, pending the Panel's final decision.

52. We announced our decision not to make interim orders on 17 September 2003.

The General Meeting

53. The meeting was held on 19 September 2003. At that meeting AuIron shareholders approved the Yarrabee Acquisition. Each resolution put to shareholders was decided in accordance with the Board's recommendations by majorities of approximately 106 million to 39 million. AuIron had 326 million shares on issue at the time.

54. Williams controlled nearly 32 million shares, 3.5 million of which it held for advisory and execution-only clients from whom it had no instructions. All of those shares were voted in accordance with the Board's recommendations. Had all of those shares been voted against the Board's recommendations, the resolutions would still have passed, though by narrow margins. Had the shares about which Williams had no instructions been voted against the Board's recommendations, the majorities would hardly have been affected.

DISCUSSION

Notice of Meeting

55. The notice of meeting clearly described the Yarrabee Acquisition and the issue of shares to RMM. Item 7 of section 611 requires holders who vote to approve an acquisition to have been provided with specific information concerning the effects of the acquisition on voting power in the company.[7] There was no challenge to, and no obvious deficiency in, the information which was provided to AuIron shareholders concerning the voting power to be acquired by RMM.

Independent expert's report

56. Item 7 also requires holders to have been given "all information known to the person proposing to make the acquisition or their associates, or known to the company, that was material to the decision how to vote on the resolution".[8] PS 74 indicates that this notice must contain an analysis of whether the proposed transaction "is fair and reasonable, when considered in the context of the interests of, the shareholders other than those involved in the proposed

[7] Required by paragraphs (b)(i) to (iv) of item 7 of section 611.
[8] paragraph (b)(v) of item 7 of section 611.

[transaction] or associated with such persons ("non-associated shareholders")".[9] As usual in these matters and as suggested by ASIC in PS 74,[10] to the extent that it required more than a description of the transaction, this element was discharged by an independent expert's report, in this case prepared by KPMG.

Principles relating to independent expert's reports

57. In advising non-associated shareholders on whether to approve a proposed acquisition under item 7 of section 611, the independent expert is concerned with the effect on those shareholders of the transaction giving rise to the acquisition. Any advantage or disadvantage for continuing shareholders which may result from that transaction may be relevant, subject to its materiality and the likelihood of it happening.

58. Since in most cases, however, the effects of the transaction will be mainly reflected in the value of shares in the company, in the end the report is principally a comparison between the value of the shares if the acquisition proceeds, and their value if it does not. In making this comparison, the expert needs to take into account as factors which will influence the value of shares in the company if the acquisition proceeds:

    (a) the comparison between the value of the shares to be acquired and the value of the consideration to be given for them; and

    (b) changes to the company which will result from the transaction (for instance the acquisition by AuIron of the Yarrabee mine and business).

59. The benchmark for the above comparison is usually the value of the shares if the company carries on business as usual. That is, the expert will in general report on whether the transaction is likely to enhance or diminish the value of the non-associated holders' shares, other things remaining equal. If, however, the board propose changes in the company's assets or business, the value of the shares after the changes may be the preferable benchmark, depending how advanced and how definite those proposals are. Similarly, the expert may need to take into account a transaction which may be closely affected by the shareholders' decision, such as a bid which (depending on its terms) may underpin the price of the shares if the acquisition is, or is not, approved.

60. In assessing the value of the shares under any of these scenarios, the expert needs to consider and assess properly any material assumptions and risk factors. Material uncertainties and aspects which are incapable of quantification should be fully disclosed and reflected in the overall assessment of the

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[9] PS 74 at para 74.9(d). PS 74 was last re-issued before the commencement of the *Corporate Law Economic Reform Program Act 1999*, which introduced the disclosure requirement in paragraph (b) of item 7 of section 611.

[10] PS 74.11 – 74.12.

proposal. Experts should avoid speculation, however: their function is to provide an analysis based on the most reliable information that they can obtain.

61. In the end, the role of the expert is to assist the shareholders with the choice they have to make, in the circumstances under which they have to make it: it is to assess existing possibilities which will be affected by that choice, not to formulate new proposals.

62. The general meeting does not manage the company and does not need advice on how to manage it. There are limited exceptions where matters which would otherwise be decided by the board are referred to the general meeting under the related party provisions, the directors' interests provisions, the listing rules or frustrating action policy. Even in these cases, the decision is made in the first instance by the directors, and shareholders provide an additional approval to the relevant action.

Specific requirements on independent expert's reports

63. In PS 74 ASIC says on the information provided to shareholders for the purposes of a resolution under item 7:[11]

> 74.20 "The issue of whether [a proposal under item 7] is "fair and reasonable" is different from the issue confronting an expert preparing a [section 640 report]. Under [section 640], an expert is required to determine whether an offer made to shareholders in a target class is fair and reasonable. This comparison of the value of the company's shares and the consideration is more straightforward than the comparison for [an item 7] resolution.
>
> 74.21 "In the context of [an item 7 proposal], what is fair and reasonable for non-associated shareholders should be judged in all the circumstances of the proposal. **The report must compare the likely advantages and disadvantages to the non-associated shareholders if the proposal is agreed to, with the advantages and disadvantages to those shareholders if it is not.** Comparing the value of the shares to be acquired under the proposal and the value of the consideration to be paid is only one element of this assessment.
>
> 74.22 "The expert should assist non-associated shareholders to make their decision by providing in the report a clear summary of the possible advantages and disadvantages to them if the proposal is accepted or rejected."
>
> [emphasis added]

[11] Current section references substituted for old.

64. Westchester submitted that these paragraphs, particularly the second sentence of paragraph 74.21(quoted in bold), relevantly meant that the KPMG Report was required to evaluate the Westchester Proposals, because those proposals would contribute to the possible advantages to non-associated shareholders if the proposal was rejected.

65. Those paragraphs must be read in the context of the remainder of the Policy Statement, in particular paragraph 8, which requires information to be provided about the effects of the proposed transaction on the company's business, capital, assets and employees as well as on control of the company. In deciding whether it is in their interests to approve an acquisition under item 7, shareholders need to assess how the transaction as a whole will affect the value of the shares they hold. Examples mentioned in PS 74 are changes of business policy made by a new controlling shareholder and the introduction into the company of additional capital, new businesses or management skills.[12]

66. In context, the relevant sentence plainly means that the report must assess the effect on the value of shares held by non-associated shareholders of the transaction as a whole, and not just assess whether the consideration to be given to acquire shares incorporates a control premium.[13]

67. In relation to a transaction such as the present, this means that the report needs to compare the value of shares held by non-associated shareholders in the company without the transaction with the value of those same shares if the transaction is completed, when the company's assets have been increased by the asset to be acquired (relevantly, Yarrabee) but the existing shares have been diluted by the issue of new shares (and potentially further diluted by issues of shares under the new options) and their value may have been affected by changes in the company's business, assets, financial position and prospects of being taken over.

68. While we agree with this policy, it offers no support to the argument put by Westchester that an independent expert must evaluate all alternative proposals for the conduct of the business of the relevant company, no matter how speculative. In some cases, the expert must evaluate alternatives to business as usual, such as:

    (a) if the proposed transaction involves a change in the company's intended business (as the Yarrabee proposal did) in assessing the effect of the transaction on the value of shares in the company, the report must assess the effect on the company of the proposed new business plan;

    (b) if the board propose to change the company's operations even if the proposed acquisition is not approved, the expert should take that proposal

[12] Paragraphs 25(b), 26 and 27.
[13] Paragraph 24.

into account in assessing the value of the company if the proposal is not approved, rather than valuing the company on the basis that it will continue business as before;

(c) in valuing the company, the expert may need to separately value assets which are surplus to its needs; and

(d) where a resolution is required under the Listing Rules or the related party provisions of the Act or a proposal which would otherwise constitute action frustrating a bid is submitted for approval at a general meeting, that meeting may need to evaluate the relevant transaction in the context of a change of business plan of which it is part.

KPMG Report

69. As discussed above, the KPMG Report evaluated shares in AuIron as it stood and shares in the merged entity comprising AuIron and Yarrabee, with its new business and enlarged share capital. It advised shareholders that the Yarrabee Acquisition was fair and reasonable to them and that it would not disadvantage them financially, on the basis that shares in AuIron would be worth more after it had acquired Yarrabee than before.

KPMG on Ballymoney

70. Westchester contended that the Ballymoney project had been undervalued by a failure to take into account the option value of Ballymoney, by applying the Black and Scholes method, and that the value of AuIron was highly dependent on both the quantum of, and the level of confidence in, the valuation of the Ballymoney project.

71. A&S state that they "reviewed the strategic options under consideration by [AuIron] and the most appropriate valuation methodologies given the circumstances involved with each strategy". They discussed at some length the appropriate valuation methodology to apply to the Ballymoney lignite deposit and gave two values.[14] The higher figure was derived by applying to AuIron's own valuation of the completed project a method they called the Development Conversion Method which determines the value of a capital development project at various stages, based on empirical studies of the sale values of partially developed projects. The lower figure was calculated by applying to AuIron's historic exploration expenditure a method they called the Multiple of Exploration Expenditure Method. A&S chose the lower of the two figures, as the higher seemed to them overly optimistic. KPMG adopted this figure, with a minor adjustment for other assets belonging to the project.

72. The use of the higher of A&S's figures would have increased the high end of the range of values derived by KPMG for the equity in AuIron by 10% and reduced

[14] See section 5.2.1.2 of the A&S Report.

the premium being paid for the shares being acquired by RMM from 30% to 20%.

73. Westchester gave no reason to doubt the soundness of either of the methodologies used by A&S. Its argument that the Black & Scholes method would have produced a higher value did not deal with:

    (a) KPMG's observation that the Ballymoney project might not proceed because of a number of factors outside AuIron's control;

    (b) A&S's observation that AuIron's right to Ballymoney was a Prospecting Licence with only a year to run; or

    (c) A&S's judgment that the higher of the two figures they themselves derived was too high.

74. We are unable to accept this criticism of the KPMG Report. KPMG overtly and properly rely on the A&S report, which gives a very clear statement of A&S's views on the appropriate valuation methodologies, the value of Ballymoney and the reasons for and degree of confidence in that valuation. Westchester give no reason to reject A&S's methods or conclusions.

KPMG on Coal Prices and Currency

75. Westchester state that KPMG does not demonstrate that it has expertise in forecasting coal prices and exchange rates, both of which are critical to the assessment of the value of the Yarrabee mine. KPMG and A&S valued Yarrabee by the discounted cash flow method, using coal prices and exchange rates supplied by KPMG and reviewed and adopted by A&S as reasonable. KPMG provided an extensive discussion of historic coal prices and both A&S and KPMG provide sensitivity analyses, showing how their valuation is affected by different assumptions concerning coal prices and exchange rates. We are unable to accept this criticism.

KPMG on SASE

76. Westchester contend that KPMG should have re-assessed the value of AuIron's interest in the SASE project, given a recent rise in world pig iron prices. We are unable to accept this argument. As mentioned above, AuIron's interest in the SASE project now consists of a revenue interest in the Ausmelt subsidiary holding the technology (of which KPMG state that successful commercial trials will be needed before revenues can be derived from it) and some iron ore and limestone tenements (which A&S valued on bases which are not directly linked to present pig iron prices). The Board said in their 3 September letter to shareholders that the SASE project was still not viable. In our view, Westchester has not shown that the rise in pig iron prices falsified any of the assumptions in these valuations.

KPMG on Tax Losses

77. KPMG noted that AuIron had $111 million in tax losses and no prospect of generating income to utilise them. Westchester objected that this proposition required further analysis to be convincing. We disagree. AuIron had at the time no operating business and (the Yarrabee acquisition aside) its only prospects of deriving substantial income were speculative, leaving to one side the question whether AuIron would be able to satisfy the tests in income tax legislation concerning the circumstances in which past tax losses may be used to reduce taxable income.

KPMG on Business as Usual

78. Westchester criticised the KPMG report as failing to provide an assessment of the value of AuIron under a business as usual scenario. While KPMG may not have been as explicit about this as perhaps they could have been, their assessment of the current value of AuIron's shares values AuIron on a "business as usual" basis. The choice of this basis was compelling, with SASE having been turned over to Ausmelt, Ballymoney closed, no other projects under way and so many projects having failed: all the company really had left was the residue of its cash and tenements.

79. KPMG say in their list of advantages of the proposed transaction that it would provide:

> "*an opportunity for AuIron to reposition the company after a history of difficult and unsuccessful projects*",

and

> "*an operating asset for AuIron and future access to cash flows for the first time which is likely to generate dividends for shareholders in the future*".

Valuation Ranges in the KPMG Report

80. We also disagree with the criticism made by Westchester of the use of valuation ranges in the KPMG and A&S Reports, on the basis that they did not include estimates of the probability of the value coinciding with the top or bottom of the range, or falling within the range. Valuation ranges were discussed by the Panel in *Email Limited (No. 1).*[15] There is nothing unusual or objectionable in the discussion by KPMG and A&S which leads up to their formulation of ranges, and the assumptions on which they derive the upper and lower limits of the ranges they mention are quite clear. For instance, on A&S's view, the value of Ballymoney is nil if no partner can be found to develop it, but could be $7 million if such a partner were found. It would be misleadingly speculative to assign a numerical probability to the prospect of finding such a partner.

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[15] [2000] ATP 5, 18 ACLC 708 at [49] – [54] and [62].

The Westchester Proposals

81. Westchester's main criticism, however, was that it was unsatisfactory that the KPMG Report contained no extended discussion of the Westchester Proposals. This criticism is wholly misplaced. Those proposals were at most background information relevant to the nominations of Messrs Ryan, Blanks and Mutton, resolutions on which the expert had not been retained to report. They were not an alternative to the Yarrabee Acquisition in the sense that the company was likely or certain to embark on them, should the Yarrabee Proposal be rejected. In any case, they were not a clearly formulated business proposal on which the expert could have placed a value: any valuation would have been highly speculative.[16]

Loss of AIM Listing

82. As mentioned above, to the extent that retention of the AIM listing and the Yarrabee Acquisition were strict alternatives, the issue whether to retain the listing was before the meeting and information on that issue was background relevant to whether to approve the acquisition. The explanatory memorandum made it clear that the AIM listing would be retained if the Yarrabee Acquisition did not proceed, but that a decision would need to be made whether to apply for re-admission to AIM, if the acquisition proceeded. This information is simply repeated in the KPMG Report.

83. On 8 September, 11 days before the meeting to consider the Yarrabee Acquisition, AuIron announced that it would not seek re-admission to AIM if the acquisition proceeded.

84. Whether to apply for re-admission to AIM, should the Yarrabee Acquisition be approved, was not before the meeting. Subject to the directors' duties under the Act and common law, that was a commercial decision for the directors of AuIron. Accordingly, there was no reason why the loss or retention of the AIM listing should have been canvassed in the KPMG Report, except as one of the factors bearing on a decision whether to approve the Yarrabee acquisition. While KPMG could have expanded on the effect of the loss of the listing, at the time they provided their report, AuIron had yet to announce its final decision not to apply for re-admission, should the Yarrabee acquisition be approved.

85. We do not believe that the loss of the AIM listing gave rise to unacceptable circumstances. While it was likely to concern some of AuIron's UK and European shareholders, AuIron remained listed on ASX. In particular, the prospect of losing the listing did not tend to coerce shareholders into approving the Yarrabee Acquisition, since AuIron had stated that the listing would continue and quotation would be resumed if the acquisition did not proceed.

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[16] Or, as KPMG put it in a submission, they were "fluid and uncertain. Therefore they can only reasonably be considered by an expert in a general rather than specific sense."

Shareholders in effect had an opportunity to approve or reject the delisting (albeit as part of a package of other transactions).

86. When Williams wrote to their clients about the merits of the Yarrabee Acquisition, they had already transferred their clients' shares to the Australian register and didn't even mention the loss of the AIM listing.

Williams shareholding

87. We discuss in this section the issue whether Williams had a relevant interest in shares held on behalf of its clients, as it is an issue likely to recur in future matters and to affect other brokers. We do not need to decide this question in the present matter, and do not decide it. In view of the outcome of the vote at the AuIron meeting and the methodical way it went about obtaining voting instructions from execution only and advisory clients, we are satisfied that unacceptable circumstances did not result from Williams' control over the AuIron shares it held for its clients.

88. On 17 September, when proxies closed for the meeting, National Nominees held about 2.8 million shares in AuIron on behalf of Williams and another 28,931,316 shares on behalf of Williams' clients, totaling about 9.7% of the issued shares in AuIron. On or about 3 September 2003, Williams wrote to its clients advising that it supported the Yarrabee Acquisition as being in shareholders' interests and it would vote all shares held by Willbro Nominees in favour of the Yarrabee Acquisition unless directed otherwise. Williams stated to us that:

> *In the event of us voting at the AuIron meeting, we will do so in accordance with the contract we have with our clients.*

89. Williams held on its own account (approximately 2.8 million shares (0.85%))[17] and for clients who have three sort of accounts:

    (a) 632,500 shares (0.2%) held for clients with discretionary accounts ;

    (b) 26,199,316 shares (8.0%) held for clients with advisory accounts; and

    (c) 2,099,500 shares (0.6%) held for clients with execution-only accounts.

    The largest parcel held for one client was two million shares (0.6%).[18]

90. Section 671B requires a person who begins to have, or ceases to have, a substantial holding in a listed company, or whose voting power in a listed company changes by 1% to provide to the company a substantial holding

[17] As at 11 September 2002, from AuIron's Annual Report for 2002. Percentages in this paragraph are based on the number of shares on issue during proceedings, which was 326 million.

[18] These figures are all from information provided by Williams as at 16 September 2003

notice, within two business days after the person becomes aware of the information.

91. A person has a substantial holding in a company if the total number of votes attached to voting shares in the company in which the person and their associates have relevant interests is 5% or more of the total number of votes attached to voting shares in the company.

92. As mentioned above, neither Williams nor its nominee had lodged a substantial shareholder notice in connection with Williams' shareholding in AuIron, on the basis that Williams had advice that it held its interests in AuIron shares as a bare trustee for its clients.

93. It is clear that, having power to direct how National Nominees voted the shares, Williams had a relevant interest in them, unless an exception applied. There was no suggestion that any exception might apply, other than that in subsection 609(2), or that Williams was a trustee of the 2.8 million house account shares referred to in [87].

Bare Trust Exception

94. The relevant parts of the definition of a relevant interest are as follows

"608(1) A person has a relevant interest in securities if they:

(a) are the holder of the securities; or

(b) have the power to exercise, or control the exercise of, a right to vote attached to the securities; or

(c) a power to dispose of, or control the exercise of a power to dispose of, the securities.

"608(8) If at a particular time all of the following conditions are satisfied:

(a) a person has a relevant interest in issued securities;

(b) the person (whether before or after acquiring the relevant interest):

(i) has entered or enters into an agreement with another person with respect to the securities; or

(ii) has given or gives another person an enforceable right, or has been or is given an enforceable right by another person, in relation to the securities (whether the right is enforceable presently or in the future and whether or not on the fulfilment of a condition); or

(iii) has granted or grants an option to, or has been or is granted an option by, another person with respect to the securities;

(c) the other person would have a relevant interest in the securities if the agreement were performed, the right enforced or the option exercised;

the other person is taken to already have a relevant interest in the securities."

"609(2) A person who would otherwise have a relevant interest in securities as a bare trustee does not have a relevant interest in the securities if a beneficiary under the trust has a relevant interest in the securities because of a presently enforceable and unconditional right of the kind referred to in sub-section 608(8)."

95. In *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 5 ACSR 720 at 746 NSW CA Meagher JA, with whom Samuels JA agreed, said of a corresponding previous provision:

> "A "bare trust" is one in which the trustee has no active duties to perform and is usually contrasted with a trust where there are such active duties. A recent discussion of the topic may be found in Gummow J's judgment in *Herdegen v FCT* (1988) 84 ALR 271. In that case, his Honour points out that the precise nuances of the phrase must depend on the context in which it is found. As a matter of strict logic a person in [the trustee's] position would theoretically have been in a position where he had an active independent duty to perform in some circumstances, for example if he found himself so situated that he had to vote at a formal meeting and [the beneficiary] had declined to instruct him how to exercise his vote. But, as a matter of strict logic, almost no situation can be postulated where a trustee cannot in some circumstances have active duties to perform. The applicants would have the phrase confined to situations where the trustee was immediately bound to transfer the share to his beneficiary. But this, in my view, is too narrow a construction, and would result in reading down the phrase so that it applied only to situations which almost never occur. Bearing in mind the evident statutory purpose, and particularly bearing in mind that s 130 imposes criminal penalties for its breach, I think the expression must be related to situations where a trustee is no more than a nominee or cypher, in a common-sense commercial view."

96. A bare trustee is a trustee with no active duties to perform, i.e. one whose only duties are to maintain the trust property and transfer it to the beneficiary on demand. The existence of a bare trust is consistent with the trustee having power to vote shares, if the beneficial owner has declined to give instructions, but not of the trustee having power to vote independently of the beneficiary.[19] An example might be a proposal to reduce capital by paying off the shares at a fraction of their worth, when the beneficial owner is out of touch. Such a

[19] *Australian Securities Commission v Bank Leumi Le-Israel and others* (1995) 18 ACSR 639 at 684

situation may enliven an active duty to vote against the reduction, to act to preserve the interest of the beneficiary.

Was Williams a Bare Trustee?

97. The shares were held under a standard form Private Client Investment Agreement adopted by Williams de Broë plc in accordance with the requirements of the Financial Services Authority.

98. As regards discretionary clients, the Agreement provides that Williams:

> "*will be responsible in the exercise of our discretion for … voting or not at meetings*".[20]

99. The wide discretionary power that the agreement confers on Williams to vote shares held for its discretionary clients without seeking instructions is inconsistent with the notion of a bare trust. We conclude that the exception in subsection 609(2) does not apply in this case and Williams had a relevant interest in those 632,500 AuIron shares as well as the 2.8 million house account shares. This was in effect conceded by Williams.

100. As regards advisory and execution-only clients, the Agreement provides that:

> "*if you wish us to exercise any rights on your behalf (for example, relating to voting at meetings) it is your responsibility to notify us of that fact (and of the manner in which you wish such rights to be exercised) on a case by case basis and in a specific and timely manner*"[21]

and

> "*We may (but shall not be under any obligation to you to) take action in the absence of your instructions in circumstances in which we in good faith consider it to be in your interests to do so. In such a case we shall notify you of the taking of such action as soon as reasonably practicable after taking it*".[22]

101. Williams submitted that it was a bare trustee of the shares held for the advisory and execution-only clients, and Westchester submitted that it was not.

102. The Private Client Investment Agreement empowered Williams to vote shares without having obtained instructions from the advisory and execution-only clients, although it had to attempt to obtain instructions before doing so and to believe that it was in the client's interests to vote the shares. The fact that this power is available in a very wide range of cases and is in effect indistinguishable from that applying to discretionary clients, except that it is defeasible by specific and timely instructions given on a case by case basis,

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[20] Clause 2.4.1
[21] Clause 2.5.1
[22] Clause 2.5.4

means that the arrangement between Williams and its advisory and execution only clients may not have been a bare trust. The difference between maintaining the trust fund and acting in the interests of the beneficiary is, however, merely one of degree, and Meagher JA warns against reading down the phrase "bare trustee" so that it applies only to situations which almost never occur.[23]

103. The view that Williams' discretion to vote clients' shares goes beyond what is consistent with a bare trust is supported by observations in the cases:

- in *Corumo v C. Itoh*, Meagher JA gave as one ground for holding that a particular trustee was a bare trustee that "the prospect of [the trustee] ever voting independently of [the beneficiary] must be remote indeed"
- in *ASC v Bank Leumi Le-Israel* Sackville J applied as one of the tests of the existence of a bare trust whether the trustee "exercises any discretion in relation to voting rights"[24]
- in *Glencore Nickel* McLure J said that "The evidence is to the effect that in the United States, the beneficial owners exercise all the voting rights and that ... the custodians are equivalent to a bare trustee (or nominee) in this jurisdiction".[25]

104. In one case, it was held that a trustee of land was not a bare trustee because he had active duties consisting of buying and selling land at the direction of the beneficiary.[26] Since brokers in general hold shares for clients (other than discretionary accounts) on a precisely similar basis, the exception has a very limited application to brokers, if the reference to a bare trust is read as narrowly as this. This case reinforces the need to study the law, policy and practice at greater length than these proceedings have allowed before trying to make a definitive decision on what is a bare trust for the purposes of subsection 609(2).

Voting Power

105. Even if the Client Services Agreement gave Williams no relevant interest in the execution-only and advisory clients' shares, it is theoretically possible that Williams had a relevant interest in the shares held for those clients, because it was acting beyond the agreement (i.e. exercising a power to vote in breach of trust - see para 608(2)(b)(i)). Williams rebutted this by providing evidence that it was gathering client instructions and had received instructions from, or spoken with, clients who owned 85% of the shares in question.

106. Strictly, it made no difference to the existence of a relevant interest that Williams sought their client's instructions. However, in practice, it made a

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[23] *Corumo v C. Itoh* (1991) 5 ACSR 720 at 747.
[24] *Australian Securities Commission v Bank Leumi Le-Israel and others* (1995) 18 ACSR 639 at 684.
[25] *Re Glencore Nickel Pty Ltd* (2003) 44 ACSR 210 at 219.
[26] *Thorpe v Bristile Ltd* (1996) 16 WAR 500 at 506

significant difference to whether there were unacceptable circumstances. Although Williams arguably had a relevant interest in AuIron shares held for execution only and advisory clients, the methodical way it went about obtaining voting instructions was evidence that Williams was not abusing that interest.

107. We have also considered whether Williams had voting power over the execution only and advisory clients' shares, as those clients had relevant interests in the shares under subsection 608(8) and Williams was associated with them, as it was acting in concert with them in relation to the affairs of AuIron by co-operating in relation to the casting of votes at a general meeting of AuIron.

108. This argument has several deficiencies, but it is enough for present purposes to note that under paragraph 16(1)(a) of the Act no association arises because one person acts on behalf of another, or gives advice to the other, in the proper performance of functions attaching to the first person's professional capacity or business relationship with the other person. The evidence available to us supports an inference that this exception applied to the services Williams provided to its clients.

Decision on Williams Interests

109. Williams plainly had a relevant interest in the shares held on the house account and for the discretionary account clients, a total of 1% voting power in AuIron. Depending on the bare trust issue, it arguably had a relevant interest in another 8.6% held for advisory and execution-only clients and in that case, it would have contravened the substantial holding notice provisions.

110. We make no finding whether Williams had breached the substantial holding notice requirements, as there was no need to resolve that question in order to deal with this application. Williams had not concealed its holdings or intentions vis à vis AuIron. It had obtained client instructions for the great majority of the shares it managed. The votes attached to the shares for which it had no client instructions were immaterial. Williams had appeared to have followed standard UK practice in good faith. In our view, Williams' conduct in relation to its clients' shares did not give rise to unacceptable circumstances.

No Decision on Bare Trust argument

111. A decision whether a broker in the position of Williams has a relevant interest in shares which it holds for clients under such a client services agreement or is a bare trustee of those shares is likely to apply to many brokers, both in Australia and in the United Kingdom. We think it preferable that the market consider the legal analysis in these reasons and take account of that in settling the terms of client services agreements. We consider that it is only when the relevant

decision will affect whether or not unacceptable circumstances exist that we should consider the discretionary policy issues relating to this question.

112. Pending clarification of the bare trust issue, it appears to us to be a conservative view supported by the cases mentioned above that a trustee of securities would not lose the benefit of subsection 609(2), merely because the instrument creating the trust allowed the trustee to cast votes attached to those securities without having obtained instructions from the beneficial owner of the shares if, in relation to the particular exercise of the voting power, the trustee:

    (a) had sought those instructions with reasonable diligence; and

    (b) believed it to be necessary to vote the securities to preserve the trust fund.

Decision

113. We dismissed the Application without making a declaration or orders. Once the time limit to seek review had elapsed, we allowed AuIron and RMM to withdraw their undertakings.

114. We consented to the parties being legally represented by their commercial lawyers in the Proceedings.

Jeremy Schultz
President of the Sitting Panel
Decision dated 22 September 2003
Reasons published 4 December 2003