



**In the matter of Pacific Energy Limited
[2004] ATP 23**

Catchwords:

content of bidder's statement - efficient market - material litigation involving bidder and target - potential conflicts of interest - agreement to modify bidder's statement and terms of takeover offers - consent to withdrawal of application

Corporations Act 2001 (Cth), Chapter 2E

These are the Panel's reasons for consenting to Pacific Energy Limited withdrawing its application in relation to a bidder's statement lodged by Energy World International Ltd. That bidder's statement related to Energy World International Ltd's off-market takeover bid for all of the ordinary shares in Pacific Energy Limited. On 13 October 2004, the Panel issued a media release regarding its decision.

THE PROCEEDINGS

1. These reasons relate to an application (the **Application**) to the Panel from Pacific Energy Limited (**PEA**) on 14 September 2004 in relation to the affairs of PEA. The Application alleged that unacceptable circumstances existed in relation to a bidder's statement lodged by Energy World International Ltd (**EWI**) in relation to its off-market takeover bid for all of the ordinary shares in PEA.
2. On 13 October 2004, the Panel consented to PEA withdrawing the Application. The request to withdraw the Application followed EWI's agreement:
 - (a) not to waive the 50% minimum acceptance condition under the terms of its bid; and
 - (b) to lodge a substantially amended bidder's statement containing further disclosure regarding a range of matters, but in particular:
 - (i) the litigation between the PEA group, on the one hand, and EWI and its associates on the other hand (the **Litigation**); and
 - (ii) EWI's intentions as to how conflicts of interest relating to the Litigation would be managed if (after the bid) EWI and its associates had relevant interests in between 50% and 90% of the ordinary shares in PEA.

THE PANEL

3. The President of the Panel appointed Les Taylor (sitting President), Graham Bradley (sitting Deputy President) and Guy Alexander as the sitting Panel (the **Panel**) to consider the Application.

APPLICATION

Background

EWI, PEA and EWI's bid

4. EWI is a company incorporated in the British Virgin Islands. PEA is a company registered in Australia and listed by Australian Stock Exchange Limited.
5. On 6 July 2004, EWI announced a takeover bid for all of the ordinary shares in PEA. EWI lodged its bidder's statement on 6 September 2004.
6. The offer contained in the bidder's statement was subject to a condition subsequent that EWI and its associates must have relevant interests in more than 50% of the PEA shares during or at the end of the offer period (the **50% minimum acceptance condition**).
7. Before EWI's bid was announced, EWI had voting power in PEA of 19.47% (EWI having a relevant interest in 11.40% of PEA ordinary shares and EWI's associates having a relevant interest in 8.07% of those shares).

Litigation

8. Prior to the bid, the following Litigation was on foot between PEA or one of its subsidiaries (on the one hand) and EWI or one of its associates (on the other hand):
 - (a) Winding up proceedings commenced by EWI against PEA's wholly owned subsidiary, Project Global Limited (**PGL**), in the High Court of Hong Kong on the grounds of the failure by PGL to pay a debt in the amount of \$576,911;
 - (b) A counterclaim by PGL against EWI for the amount of \$906,581;
 - (c) A PEA claim against EWI in the Supreme Court of Western Australia seeking repayment of \$1,307,283 in respect of an alleged breach of a co-investment agreement between EWI and PEA;
 - (d) Proceedings commenced by the owner of EWI (Mr Stewart Elliott), and a company controlled by him (Asia World Holdings Ltd (**AWH**)), against PEA and PGL in the Industrial Relations Commission of New South Wales with respect to the employment contract of Stewart Elliott as chief executive officer of PEA. The total amount claimed was \$483,333 plus costs and interest; and
 - (e) Proceedings commenced by Stewart Elliott and AWH against PEA and PGL in the Federal Court of Australia in relation to representations made by officers of PEA and PGL. The amount claimed was \$496,042 plus damages, interest and costs. These proceedings related to substantially the same underlying circumstances as those described in paragraph (d).
9. Given PEA's size and financial position, the Litigation was highly material to PEA.

Alleged unacceptable circumstances

10. PEA alleged that unacceptable circumstances existed because of misleading or deceptive statements in, or material omissions from, EWI's bidder's statement. Specifically, PEA alleged that the bidder's statement was deficient in that it did not set out:

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- (a) an adequate description of the nature of each of the proceedings comprising the Litigation;
- (b) EWI's knowledge as to the prospects of success with respect to each of the proceedings comprising the Litigation;
- (c) EWI's calculation of the financial impact upon PEA if EWI and its associates were successful in each of the proceedings;
- (d) how EWI intended that the independent directors were going to manage and review the Litigation;
- (e) whether EWI and its associates would continue the proceedings brought by them against PEA if EWI's bid succeeded;
- (f) whether EWI intended that PEA and PGL would continue the proceedings brought by PEA and PGL against EWI if EWI's bid succeeded;
- (g) whether EWI would appoint a liquidator if the winding-up proceedings were successful and, if so, what the consequences would be, and, if not, how the necessary funds would be raised;
- (h) information concerning the track record and performance of Energy World Corporation Limited (EWC) while that company had been controlled by EWI (as at the date of lodgment of the bidder's statement, EWI owned 58.56% of the shares in EWC);
- (i) the details of facilities or financial services provided by EWI or its associates to related parties of EWI, including EWC;
- (j) information concerning transactions between EWC and EWI;
- (k) the identities of the intended directors of EWI; and
- (l) adequate information about how EWI would fund its bid.

PEA also alleged that the bidder's statement was misleading in the way that it described the history of EWI's representation on the board of PEA.

11. Finally, PEA argued that the Panel should require that EWI's bid be conditional on EWI and its associates having a relevant interest in 90% of the ordinary shares in PEA at the end of the offer period for the bid (that is, that EWI's bid be subject to a **90% minimum acceptance condition**). PEA submitted that this was the only way to ensure that the interests of minority shareholders would be protected from conflicts of interest which would arise if EWI became a controlling shareholder of PEA.

Declaration and orders sought in the Application

12. PEA sought:
 - (a) a declaration of unacceptable circumstances under section 657A of the *Corporations Act 2001* (Cth);
 - (b) interim orders restraining EWI from dispatching the bidder's statement to PEA shareholders pending final determination of proceedings by the Panel; and

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- (c) final orders to rectify the alleged deficiencies in the bidder's statement and to require EWI's takeover offer to be made subject to a 90% minimum acceptance condition.

DISCUSSION

Interim orders

13. Shortly after the Panel received the Application, EWI indicated that it would seek to resolve many of the issues raised by negotiation with PEA. In connection with this, EWI gave an undertaking to PEA and the Panel that it would not dispatch its bidder's statement without 48 hours' prior written notice to both PEA and the Panel. Accordingly, the Panel made no interim order, pending the success or failure of the negotiations.
14. From the Panel's perspective, the 48 hour period would have allowed it the opportunity to consider whether an interim order would be appropriate if negotiations between EWI and PEA were not resolved to their mutual satisfaction.
15. The Panel was not required to reconsider whether an interim order was appropriate because EWI agreed to amend its bidder's statement to the mutual agreement of PEA and EWI before dispatching it.

Negotiations between the parties

Changes to the bidder's statement

16. The negotiations between PEA and EWI resulted in substantial changes to the bidder's statement. Many of those changes directly addressed PEA's original concerns as outlined in paragraph [10]. In addition, PEA determined not to pursue some of its original concerns, either because it considered it unnecessary to do so or because it considered that it could adequately address them in its target's statement.
17. Among other things, the negotiated changes to the bidder's statement included:
 - (a) a description of the Litigation and information on the 'best-case' and 'worst-case' scenarios for PEA if that Litigation were resolved in particular ways;
 - (b) clarification that EWI and its associates intended to pursue the Litigation (other than the winding up proceeding) if EWI acquired control of PEA;
 - (c) representations that, if EWI acquired control of PEA, EWI intended to:
 - (i) retain three of the five existing directors of PEA (each of whom was not associated with EWI) as non-executive directors of PEA; and
 - (ii) establish a Litigation Committee comprising non-executive directors, independent of EWI and Stewart Elliott, to handle all aspects of the Litigation. Those directors would either comprise the three existing directors of PEA or, if any of those directors resigned, their independent replacements. The Litigation Committee would have full authority to do all things appropriate and expedient to conduct the Litigation on behalf of the PEA group.

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Prospect of coercive effect

18. Following the negotiated changes (to which the Panel did not object), the Panel's major concern was to ensure that the combination of the Litigation and the bid should not have an unacceptable coercive effect on PEA shareholders.
19. In this regard, the Panel considered that it would not be consistent with the existence of an efficient, competitive and informed market if PEA shareholders felt that they had no choice but to accept a bid (irrespective of whether they considered that it was adequately priced) because of concerns that EWI would not properly manage the defence of the Litigation if it acquired control of PEA.

Protections for shareholders

20. At the same time, the Panel was conscious that it may not have been in the interests of PEA shareholders to deny them the opportunity to exit PEA at a premium to recent trading prices.
21. The Panel recognised that there were various regulatory and common law protections to protect the interests of minority shareholders in related party scenarios. For instance, Chapter 2E of the Corporations Act and directors' duties generally.
22. The Panel also welcomed EWI's decision to set out in its bidder's statement how it intended that PEA would handle the Litigation if EWI acquired control of PEA. However, the Panel considered that it would be appropriate for the bidder's statement also to set out EWI's intentions with respect to:
 - (a) the resourcing of the Litigation Committee; and
 - (b) the management of the Litigation, if none of the three existing directors of PEA consented to their appointment to the Litigation Committee or if one of their positions became vacant other than due to a resignation.
23. EWI agreed to amend its bidder's statement to address these issues and clarify that it was intended that the Litigation Committee would be adequately resourced (out of PEA funds) and that there would always be at least three non-executive directors of PEA who were independent of EWI and Stewart Elliott on the Litigation Committee.
24. The Panel recognised that it would have been preferable if the various intentions expressed by EWI instead comprised firm undertakings. The Panel also recognised that EWI could not give absolute commitments given that many of the decisions would ultimately be those of the PEA board (and given that the intentions were relevant in the case where EWI had less than 100% control of PEA). Accordingly, given that the Litigation gave rise to the prospect of coercion, the Panel considered that it was appropriate that EWI should represent in its bidder's statement that it would use its best endeavours to ensure that its intentions with respect to the management of the Litigation were carried out. EWI agreed to include such a representation.
25. However, the Panel remained concerned that – by themselves – the measures described above would be insufficient to reduce to an acceptable level the potential coercive effect described in paragraph [19].

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Acceptances because of a possible or actual change in control

26. Short of prohibiting the bid altogether, the potential for coercion described in paragraph [19] could only have been eliminated by requiring that the EWI bid should be made subject to a 90% minimum acceptance condition which could not be waived. However, the Panel was concerned that there would likely not be a difference in practice between prohibiting the bid altogether and requiring that it be subject to a non-waiveable 90% minimum acceptance condition: in either case, there was a significant risk that PEA shareholders would be denied the opportunity to sell out of a company which was the subject of material Litigation at a premium to recent trading prices. In this context, the Panel was particularly conscious of the possibility that the outcome of the Litigation would have a material adverse effect on the value of PEA shares. The Panel was also mindful that PEA shares had been trading on the basis of the 50% minimum acceptance condition since the lodgement of PEA's bidder's statement.
27. The Panel did not consider that there was sufficient information in the Application to warrant requiring EWI's bid to be subject to a non-waiveable 90% minimum acceptance condition. That said, the Panel's decision should not be taken as authority for the proposition that where there is material litigation between a bidder and target it will never be appropriate to require that the bid proceed subject to a 90% minimum acceptance condition. For instance, the Panel might be particularly concerned if it were presented with evidence suggesting that litigation had been initiated by a bidder or one of its associates with the purpose of distorting the price of the target's shares so that the bidder could acquire the target at below its true market value.

Restriction on waiver of 50% minimum acceptance condition

28. However, the Panel remained concerned that shareholders might accept into EWI's takeover bid because they were concerned that the Litigation might be handled against the best interests of minority shareholders in PEA if EWI acquired control of PEA. This was particularly so in circumstances where control might have passed to EWI without EWI receiving sufficient acceptances to give it more than 50% of PEA but with EWI having waived its 50% minimum acceptance condition (there would still be the possibility of coercion if EWI satisfied the 50% minimum acceptance condition, but at least in those circumstances shareholders would have received a bid at a price which holders of over 50% of shares believed was satisfactory). In response to this concern, EWI agreed to modify the terms of its takeover bid (and thus its bidder's statement) so that it could not waive the 50% minimum acceptance condition. This decision also ensured that shareholders in PEA would have a reasonable opportunity to accept EWI's takeover bid after control of PEA passed to EWI (if, in fact, control did pass) (because the offer period would be extended by 14 days if the 50% threshold were passed during the last 7 days of EWI's bid). This in turn would ensure that shareholders should not feel pressured into accepting the takeover bid merely because effective control *might* pass to EWI.
29. Under this scenario, it remained possible that some PEA shareholders might be denied the opportunity to realise a takeover premium (because only a small number of shareholders accepted EWI's bid and EWI might otherwise have been prepared to

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waive its 50% minimum acceptance condition). However, this result would only eventuate if holders of less than 30% of PEA shares deemed the offer price sufficient to motivate them to accept the offer and EWI had in fact waived the 50% minimum condition. In the Panel's view, the loss of this possible benefit was outweighed by the protections outlined in paragraph [28] which flowed from removing the ability of the bidder to waive the 50% condition.

DECISION

30. The Panel consented to the Application being withdrawn having regard to the amendments made to the bidder's statement by EWI. The Panel consented to the withdrawal before commencing proceedings and hence made no declaration of unacceptable circumstances or final orders.

Les Taylor

President of the Sitting Panel

Decision dated 13 October 2004

Reasons published 17 December 2004