



**In the matter of Austral Coal Limited 01
[2005] ATP 11**

Catchwords:

Unacceptable circumstances – failure to disclose material information – materiality of information – bidder’s statement – withdrawal rights.

Corporations Act 2001 (Cth) sections 643, 650D.

These are the Panel’s reasons for concluding proceedings without making a declaration of unacceptable circumstances or orders and without accepting any undertakings in regard to a scrip takeover offer by Centennial Coal Company Limited for Austral Coal Limited during the course of which Centennial announced its decision to close its Munmorah mine. The Panel did not believe the possible closure of that mine was material to the decision of Austral Coal shareholders whether or not to accept Centennial’s offer; therefore, any absence of disclosure in the Centennial bidder’s statement concerning the possible closure of Munmorah did not constitute unacceptable circumstances.

THE PROCEEDINGS

1. These reasons relate to an application (the **Application**) to the Panel dated 12 May 2005 by Glencore International Limited and Fornax Investments Limited (**Glencore**) (the **Application**) under section 657C of the *Corporations Act 2001* (Cth) (the **Act**) in relation to the affairs of Austral Coal Limited (**Austral Coal**).
2. The Panel dismissed Glencore’s application and determined not to make a declaration of unacceptable circumstances or interim or final orders. The Panel saw no need to accept any undertakings.

THE PANEL & PROCESS

3. The President of the Panel appointed Meredith Hellicar (sitting President), Guy Alexander (sitting Deputy President) and Hamish Douglass as the sitting Panel for the proceedings (the **Proceedings**) arising from the Application.
4. The Panel adopted the Panel's published procedural rules for the purposes of the Proceedings.
5. The Panel consented to parties being legally represented by their commercial lawyers in the Proceedings.

SUMMARY

6. On 23 February 2005, Centennial Coal Company Limited (**Centennial**) announced a takeover offer for all of the shares in Austral Coal (**Offer**). The bidder’s statement for the Offer (**Bidder’s Statement**) was served on Austral Coal on 9 March 2005 and despatched to Austral Coal shareholders on 21 March 2005. The Offer offered 10 Centennial shares for every 37 Austral Coal shares.

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7. On 29 April 2005, Centennial announced as part of its quarterly report for the quarter ending 31 March 2005 that its Munmorah coal mine (**Munmorah**) would be closed in August 2005 (**29 April Announcement**). During the course of that day, the trading price of Centennial shares fell by more than 10% (although there was a subsequent recovery in that trading price).
8. Glencore made an application to the Panel alleging that unacceptable circumstances existed in that Centennial had knowledge of the decision to close, or likelihood of a decision to close, Munmorah before this time, that this was information which was material to the value of Centennial shares and that, therefore, this information should have been disclosed to Austral Coal shareholders at the time it became known.
9. Glencore's primary submission was that the fall in market price of Centennial shares was evidence that closure of Munmorah was information that was material to the price of Centennial shares and, therefore, to Austral Coal offerees, and should have been disclosed earlier.
10. The Panel considered that the decision by the directors of Centennial to close Munmorah was not material to the decision of Austral Coal shareholders whether or not to accept the Offer. The Panel accepted Centennial's submissions that the primary method of determining the materiality of the closure of Munmorah to the value of Centennial shares was an objective assessment of its relative effect on certain financial measures of Centennial relevant to the value of its shares, such as Centennial's future profitability and the net asset value of its balance sheet.
11. The Panel considered that the figures provided by Centennial as to the significance of Munmorah, particularly its negative to at best break even net earnings and the small size of the one-off closure costs relative to a company with market capitalisation in excess of \$1 billion, demonstrated that the closure of Munmorah was not material to the price of Centennial shares. The Panel considered it likely that the sharp fall in price following the 29 April Announcement was a market over-reaction which was more reflective of the incomplete disclosure in the 29 April Announcement of the (potentially positive) effects of the closure on Centennial than of the materiality of the closure of Munmorah.
12. The Panel, therefore, considered that the closure of Munmorah was not material to the decision of Austral Coal shareholders whether to accept the Offer and, in turn, that the absence of disclosure about the closure of Munmorah, the likelihood of closure of Munmorah, or the progress of Centennial's review of Munmorah, in the Bidder's Statement or at any time before the 29 April Announcement, did not constitute unacceptable circumstances.

BACKGROUND

13. On 27 January 2005, Centennial released its quarterly report for the quarter ending 31 December 2004, containing the following disclosure about Munmorah:

Poor ground conditions continued in the quarter resulting in lower than anticipated production. Productivity should improve during the second half of the year with one unit now on extraction. All options are currently being reviewed for Munmorah due to its ongoing poor productivity.

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14. On 23 February 2005, Centennial announced its Offer for Austral Coal. The Bidder's Statement was served on Austral Coal on 9 March 2005 and despatched to Austral Coal shareholders on 21 March 2005. The Offer was all scrip, offering 10 Centennial shares for every 37 Austral Coal shares.
15. On the same day, Centennial released its half yearly report for the first half of the financial year ending 30 June 2005. Under the "Profit" heading in the review of operations and comments by directors, Centennial stated:

Also impacting the result was the poor performance of the Munmorah mine due to continuing poor ground conditions resulting from seam rolls and faulting. A review is being conducted of the Munmorah mine due to its continuing poor productivity.
16. On 23 March 2005, Centennial declared the Offer unconditional. Centennial also announced that if shareholders accepted before 7 April 2005, they would be entitled to participate in Centennial's interim dividend for the financial year ending 30 June 2005 of 6 cents per share.
17. On 5 April 2005, Glencore announced that it had acquired approximately 5% of Austral Coal and had entered into equity swap arrangements giving it exposure to an additional 7.4% of Austral Coal. Glencore also announced that it was assessing a number of options, including the possibility of a cash takeover bid for Austral by a party other than Centennial. At this time Centennial held 34.34% of Austral Coal.
18. On 7 April 2005, as part of its ongoing substantial holding notice disclosures, Centennial announced that it acquired 50.4% of Austral Coal.
19. On 29 April 2005, Centennial released its quarterly report for the quarter ending 31 March 2005 (**29 April Announcement**). Centennial did not release a supplementary bidder's statement in connection with that report.
20. The 29 April Announcement contained the following disclosure in regard to Munmorah:

Further deterioration of mining conditions and ongoing losses in March has led to a decision to close Munmorah Mine. As a result of Munmorah's losses and closure costs, reported FY 2005 NPAT will now be significantly less than 2004. ...

Munmorah (100% interest). As previously advised, Munmorah operates in difficult physical conditions and suffers from poor coal quality and continuing operational difficulties. As a result of extreme thinning of the seam and seam rolls encountered in late March 2005 and despite the introduction of lower-height equipment, the mine continues to fall short of production targets and sales commitments.

When purchased as part of the ex-Powercoal suite of mines, Munmorah was known to be the most difficult and highest cost mine. As previously advised, a thorough review of Munmorah has been underway for sometime. Following a poor March 2005 result, that review was completed and a decision has now been made to close Munmorah in August 2005.

The impact of Munmorah's continuing losses and the associated cost of closure, totalling around A \$22 m (pre-tax), will be a major influence on the FY 2005 result, reducing reported net profit after tax when compared with FY 2004.

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21. Although not set out in the 29 April Announcement, in regard to Munmorah's losses of \$21.6 million, a significant proportion were non-cash costs or one-off costs, and a proportion of the loss had already been included in the results for the 6 months to 31 December 2004 (see paragraph 37(g) below).
22. The Centennial share price fell more than 10% between 28 April 2005 and 29 April 2005 from \$4.92 to \$4.40¹ and from \$4.78 at the open of trading on 29 April 2005 to \$4.45 at the close of trading on that day. By this time Centennial had acquired over 82% of Austral Coal. However, by 19 May 2005, the price of Centennial shares had recovered to \$4.94.

APPLICATION

Unacceptable circumstances

23. On 12 May 2005, Glencore made an application to the Panel alleging that the facts set out above constituted unacceptable circumstances and seeking interim and final orders.
24. Glencore's application alleged that:
 - (a) the closure of Munmorah was material to the value of Centennial shares and, therefore, material to Austral Coal shareholders and to the market for control of Austral Coal shares; and
 - (b) Centennial had material knowledge about the closure of Munmorah (specifically, about the decision to close or the likelihood that such a decision would soon be made) prior to 29 April 2005 that it had not disclosed.
25. It was, therefore, argued that this information should have been disclosed in the Bidder's Statement or in a supplementary bidder's statement when it became known. By not doing this, Centennial allowed Austral Coal shareholders to accept its Offer under the impression that Centennial shares were worth more than they actually were.
26. Glencore also submitted that it had commenced preparations to make a rival bid for Austral Coal, pending finalisation of advice and documentation. However, before Glencore was in position to commence the bid, Centennial reached a level of acceptances that would have made such a bid futile.
27. Glencore argued that had Centennial made timely disclosure concerning Munmorah, Austral Coal shareholders would not have accepted the Offer at the rate they did, and Glencore would have been able to make its bid. By virtue of Centennial's conduct, Glencore was deprived of the opportunity to make, and Austral Coal shareholders were deprived of the opportunity to receive, the proposed bid.
28. Glencore submitted that these facts constituted unacceptable circumstances.

Interim orders sought

29. Glencore sought the following interim orders:

¹ Based on the volume weighted average trading price on these two days.

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- (a) an order that Centennial not process acceptances of the Offer received after the date of the Application;
- (b) an order that Centennial not send to persons who have lodged acceptances of the Offer the consideration under the Offer; and
- (c) any other order that the Panel considered necessary or desirable.

Final orders sought

30. Glencore sought the following final orders:

- (a) an order requiring Centennial to prepare and send to Austral Coal shareholders a supplementary bidder's statement containing:
 - (i) full information concerning the review of Munmorah and the decision concerning its closure (including information concerning relevant dates and actions); and
 - (ii) a right for each shareholder who has, at the time of the order, accepted the Offer to withdraw their acceptance on terms equivalent to section 650E (notwithstanding that the Offer is not currently subject to defeating conditions),

such supplementary bidder's statement to be in terms acceptable to the Panel and not to be dispatched until Glencore has had a reasonable opportunity to review the proposed supplementary bidder's statement and to provide comments on it to the Panel; and

- (b) any other order that the Panel considered necessary or desirable.

DISCUSSION

Interim Orders

31. Centennial tendered the following submissions against the Panel making the interim orders sought by Glencore:

- (a) Centennial held at the time of the Application 83.16% of Austral Coal. Centennial had processed the vast majority of the acceptances constituting this 83.16% and at the time of the Application there were only 150 accepting Austral Coal shareholders who remained to be placed on the Centennial register;
- (b) Of the remaining 16.84%, Glencore then held 7.32% and had cash-settled equity swaps accounting for an additional 6.40%. This left an effective free float of only 3.12%;
- (c) Of this remaining 3.12%, the majority of those shares (1.87%) had been acquired by hedge funds after the 29 April Announcement;
- (d) The remaining shares (1.25%) represented only 370 shareholders;
- (e) All remaining Austral Coal shareholders now had notice that Panel proceedings were on foot.

32. The Panel noted Centennial's submissions and that the interim orders sought by Glencore would, accordingly, have had very little practical effect. The Panel declined to make the interim orders requested by Glencore.

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33. At the same time, the Panel considered whether it needed to make interim orders regarding extension of the Offer which was then scheduled to close in two days' time on 17 May 2005. The Panel declined to make any such interim order on the basis that the requested final orders, if they were made, would not require the Offer to remain open. On 17 May 2005, Centennial extended its Offer to 30 May 2005.

The substantive issues - general principles

34. In order to show that unacceptable circumstances existed, Glencore was required, and sought, to demonstrate that:
- (a) Munmorah was material to the value of Centennial shares and its closure was material to the decision of Austral Coal shareholders whether or not to accept the Offer; and
 - (b) Centennial misled Austral Coal shareholders by failing to disclose material information it had regarding the closure of Munmorah prior to the 29 April Announcement and by making misleading disclosures regarding that mine prior to that time.
35. These matters are discussed separately below.

Materiality of Munmorah

Parties' Submissions

36. Glencore raised the following principal arguments in support of its contention that the closure of Munmorah was material to Austral Coal shareholders:
- (a) Centennial shares fell more than 10% on the day the 29 April Announcement was released. Because the Offer was all scrip, material movements in the price of Centennial shares were material to the decision of Austral Coal shareholders whether to accept the Offer. Glencore submitted that the only adverse information in that announcement was the closure of Munmorah;
 - (b) Glencore submitted that, while one may use financial indicators (such as the relative effect an event will have on the net earnings of a company) as a measure of likely materiality, when one has before them a pattern of trading that clearly indicates that an event was in fact considered to be material by investors, that pattern of trading must outweigh the financial indicators in the assessment of whether the event was in fact material;
 - (c) The April 29 Announcement included the following statements which Glencore argued suggested the closure of the mine was material:

As a result of Munmorah's losses and closure costs, reported FY 2005 NPAT will now be significantly less than 2004 ... The impact of Munmorah's continuing losses and the associated cost of closure, totalling around A \$22 m (pre-tax), will be a major influence on the FY 2005 result, reducing reported net profit after tax when compared with FY 2004.
 - (d) Commentary by brokers on the 29 April Announcement indicated some level of concern at the size of the closure costs.

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- (e) Centennial had in place long term fixed price supply contracts to a generator near to Munmorah. If this customer could not be supplied from other mines, the closure of Centennial may have a material effect on revenue.
37. On the question of materiality, Centennial made the following principal submissions:
- (a) Munmorah represented less than 1% of Centennial's proved and probable reserves.
 - (b) Munmorah represented less than 5% of Centennial's revenue for the first half of the financial year ending 30 June 2005.
 - (c) The carrying value of Munmorah in Centennial's accounts was 0.15% of Centennial's market capitalisation. Munmorah in fact made no positive contribution to the market's valuation of Centennial.
 - (d) Munmorah's contribution to Centennial's net earnings was negative to at best break even. The closure therefore would have no material negative impact on Centennial's earnings going forward.
 - (e) While some analysts commented on the size of the one-off closure costs, analysts generally viewed the decision to close Munmorah as not material to the value of Centennial.
 - (f) By 19 May 2005, the price of Centennial shares had recovered to \$4.94, which was higher than the price on the day immediately preceding the 29 April Announcement.
 - (g) In regard to Munmorah's losses of \$21.6 million (including closure costs) as detailed in the 29 April Announcement, Centennial noted that:
 - (i) the loss was pre-tax and comprised:
 - (A) \$4.9 million expected cash operating loss for 2005;
 - (B) \$2.8 million of depreciation for 2005;
 - (C) \$13.9 million of one-off costs (\$9.7 million after tax) associated with poor mine performance (purchased coal) or closure of the mine (this included the carrying value of Munmorah which was \$2.7 million and was non-cash); and
 - (ii) \$7.8 million of this loss had already been included in profits for the 6 months to 31 December 2004. The one-off Munmorah cash costs of \$11.2 million (\$7.8 million after tax) are equivalent to 2.9 cents per Centennial share.
 - (h) These one-off closure costs were not material in the context of a company with total assets, and enterprise value, in excess of \$1 billion (even assuming a negative effect of \$21.6 million which, per the above, the real impact was submitted to be well below).
 - (i) Centennial has never considered Munmorah to be material and has never disclosed information concerning the mine other than through its periodic reports.

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- (j) If one were to revalue Centennial following closure of Munmorah using a capitalization of earnings or discounted cash flow methodology, the downward value adjustment would be 2.9 cents, which is not material in the context of a share price of approximately \$4.90 on 29 April 2005 and usual daily share price fluctuations.
- (k) The 10% fall in Centennial's share price on 29 April 2005 indicates an over-reaction by the market to the closure of Munmorah, owing to a lack of understanding by investors and an oversensitivity of the market to profit downgrades announced by similar companies in the market at the time.
- (l) By 19 May 2005, the price of Centennial shares had recovered to \$4.94.

Panel's considerations

- 38. The Panel, in considering the arguments put in turn by Glencore and Centennial on the question of materiality, considered that the primary method of determining the materiality of the closure of Munmorah to the value of Centennial shares was to consider its relative effect on certain financial measures of Centennial relevant to the value of its shares, such as the net assets on its balance sheet and its future profitability. This is an objective test.
- 39. The Panel did not accept Glencore's submissions that the sole determinant of the materiality of the 29 April Announcement was the actual reaction of the market after the relevant news was announced, where a quantitative financial analysis would indicate that the news was not material and the market had over-reacted.

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Effect on Centennial's earnings

40. The Panel noted in particular Centennial's submission that, Munmorah having no or negative contribution to net earnings of Centennial, its closure could have had no material negative impact on the net earnings of Centennial going forward and may have had a positive impact. While the one-off closure costs may have had a material impact on net earnings in the year to 30 June 2005, those costs would not be incurred in any future years. Further, at least part of these costs would be required to be incurred at the end of the mine's life in any circumstances, so some of the effect was merely to move the timing of inevitable costs.

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Closure costs

41. The Panel also noted that, to the extent the one-off closure costs were real cash costs, they were not material to a company with market capitalisation in excess of \$1 billion.

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Other information in the 29 April Announcement

42. The Panel considered further that there was other information content in the 29 April Announcement which could have explained the market movement in Centennial shares immediately after that announcement. Therefore, it was not reasonable to ascribe the change in market price of Centennial shares after the 29 April Announcement solely to the announcement of the future closure of Munmorah.

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Market reaction

43. There was some argument among the parties as to the appropriate way to measure the fall in Centennial's share price on 29 April 2005 and its recovery after that date. The arguments centred around whether the recovery was a result of the market correcting its over-reaction to the closure of the mine, or a result of other news affecting coal companies generally, and the other companies and indices against which an appropriate comparison could be made for this purpose.
44. Centennial pointed out that, by 19 May 2005, the price of Centennial shares had recovered to \$4.94, which was higher than the price on the day immediately preceding the 29 April Announcement.
45. While noting the fall in Centennial's share price on 29 April 2005 and its subsequent recovery, the Panel considered that a detailed analysis of the market movements and speculation as to the reasons behind them was not instructive on the question of materiality. The Panel considered that the financial analysis described above was the primary method of determining the materiality of the closure of Munmorah.

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Conclusion

46. On the basis that closure of Munmorah was not material to the value of Centennial shares, it was not material to the decision of Austral Coal shareholders whether to accept the Offer. The Panel considered that any Austral Coal shareholder who had decided to accept the Offer would not have reversed that decision if they had been given detailed information about Munmorah and the effect of its closure on the long term value of Centennial. Indeed, some may have been more inclined to accept the Offer rather than less.
47. Therefore, any lack of disclosure in relation to the prospect of the closure of Munmorah did not constitute unacceptable circumstances.

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Adequacy of 29 April Announcement

48. In saying this, the Panel notes the assertions by Centennial that, with more time and subsequent explanation from Centennial, the market and analysts considered that the closure of Munmorah did not have a material adverse effect on the value of Centennial. The Panel also notes that the operating losses which Centennial advised the Panel that Munmorah had been making in the first half of the financial year ending 30 June 2005 equalled close to 5% of Centennial's EBITDA (and were, on that basis, disproportionate to its carrying value in Centennial's accounts). On that basis, the disclosure relating to Munmorah and the benefits associated with its closure, both prior to and in, the 29 April Announcement, may have been better.

Adequacy and timeliness of disclosure by Centennial of Munmorah information

Centennial's knowledge concerning Munmorah

49. Glencore alleged that Centennial had knowledge of the prospects of closure of Munmorah prior to the 29 April Announcement.
50. If Centennial had withheld material information concerning the prospects of Munmorah prior to the lodging of its Bidder's Statement on 9 March 2005, which it did not disclose until the 29 April Announcement, and the effect of closing Munmorah was material to the value of Centennial shares, that may have constituted unacceptable circumstances.
51. Similarly, if Centennial had material information concerning the prospects of *closing* Munmorah, after lodging its Bidder's Statement on 9 March 2005 but prior to the 29 April Announcement, which it did not disclose until the 29 April Announcement, and the effect of closing Munmorah was material to the value of Centennial shares, that may also constitute unacceptable circumstances.
52. However, both of these analyses are based on the assumption that the closure of Munmorah was information which was material to the decision of Austral Coal shareholders.
53. Given that the Panel concluded that the closure of Munmorah was not material to the decision of Austral Coal shareholders, the important aspect of the state of knowledge of the directors of Centennial was whether they had reasonably concluded that the operations of Munmorah and its closure, or potential closure, was not material to the value of Centennial shares.

Centennial's disclosure regarding Munmorah

54. It was generally conceded that there had been no disclosure of information in the Bidder's Statement concerning the possibility of closure of Munmorah.
55. The fact that there was to be a review of the operations of Munmorah was disclosed in the 30 December 2004 quarterly report with a statement that "All options are currently being reviewed". In the financial report for the half year ended 31 December 2004, Centennial had also disclosed that Munmorah had been making losses. However, it was noted that these disclosures were not made specifically to Austral Coal shareholders.

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56. However, given the Panel's decision in relation to the materiality of the Munmorah closure on the decision of Austral Coal shareholders, the lack of disclosure specifically to Austral shareholders concerning Munmorah's potential closure did not constitute unacceptable circumstances.
57. The Panel noted Centennial's submission to the Panel that the decision to close Munmorah had been made by the directors of Centennial at a board meeting on 28 April 2005, the day before the 29 April Announcement. The Panel did not reject Centennial's submissions as to when the decision to close Munmorah was made and the process leading to that decision.
58. However, once the Panel determined that the information concerning the closure, or potential closure of Munmorah was not material to the decision of Austral Coal shareholders, the question as to whether this information could have been disclosed sooner ceased to be relevant.

Relevance of "Proved Reserves"

59. Glencore alleged that by reporting, both prior and during the Offer, that Munmorah contained "Proved Reserves", Centennial had compounded the omission of information in the Bidder's Statement.
60. The Panel accepted Centennial's submissions that there is no accepted industry practice for making, and the JORC Code does not require a company to make, statements downgrading a mineralisation resource based on changing information on the economic feasibility of mining, extracting or processing the product of a mine. The Panel accepted Centennial's submissions that because Munmorah's reserves at 4.6 million tonnes represented less than 1% of Centennial's reserves of 480.5 million tonnes (excluding Austral Coal's resources), an announcement of the closure of Munmorah (which implies that mining the reserves at Munmorah is uneconomic) in the next periodic report was appropriate, which is what Centennial submitted it was intending to do, and did in the form of the 29 April Announcement.

Glencore's takeover plans

61. Glencore submitted that it was seriously contemplating making a takeover bid for Austral Coal prior to the rapid acceptance of the Offer in early April 2005. It submitted that the failure of Centennial to disclose the closure, or potential closure, of Munmorah in the Bidder's Statement and during that period of early April 2005, meant that Glencore's ability to make a takeover bid was thwarted.
62. Glencore submitted that it constituted unacceptable circumstances for the potential for a rival bid to be thwarted by inadequate disclosure of material information. Glencore set out the timing of its preparations for making its own takeover bid for Austral Coal, at a minimum price of \$1.40 per Austral Coal share.
63. The Panel did not reject Glencore's submissions as to its preparations for a possible takeover bid for Austral Coal.
64. However, once the Panel determined that the information concerning the closure, or potential closure of Munmorah was not material to the decision of Austral Coal shareholders, the timing of that disclosure was no longer relevant to the success or failure of Glencore's intention to make a takeover bid for Austral Coal.

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65. The Panel also noted that at the time Glencore advised it was instructing its solicitors to commence preparations for a possible takeover bid for Austral Coal, Centennial's bid had been announced for over five weeks. Glencore noted that a bid for Austral Coal would have been financed from within Glencore's internal reserves. On that basis, the Panel did not consider that Glencore had had inadequate time within which to consider and announce a takeover bid (or even the possibility of a takeover bid) for Austral Coal. Therefore, the rate of acceptances of the Offer, even if spurred by any alleged overvaluation of Centennial shares due to the absence of disclosure concerning Munmorah, did not appear to have been a material factor depriving Austral Coal shareholders of Glencore's takeover bid.

Form of disclosure of Munmorah closure

66. Glencore alleged that the disclosure of the Munmorah closure should have been made in a supplementary bidder's statement rather than solely in a quarterly production and operations report by Centennial.
67. Given the materiality of the Munmorah closure to the decision of Austral Coal shareholders, the Panel considered that the method of disclosure of the information was adequate.

DECISION

Declaration

68. For the reasons set out above, the Panel declined to make a declaration of unacceptable circumstances.

Orders

69. Given the Panel's decision not to make a declaration of unacceptable circumstances, it made no orders.

Costs

70. Centennial requested the Panel order Glencore to pay its costs. The Panel, having made no declaration of unacceptable circumstances, was not empowered under section 657D to make such an order.

Undertakings

71. The Panel did not accept undertakings from any party.

Meredith Hellicar

President of the Sitting Panel

Decision dated 23 May 2005

Reasons published 18 July 2005