Takeovers Panel

Reasons for Decision Tower Software Engineering Pty Limited 01

In the matter of Tower Software Engineering Pty Limited 01
[2006] ATP 20

Catchwords:
Early dispatch of bidder's statement – disclosure in bidder's statement – finance for bid – relevant interest – voting power – undertakings in relation to extension of bid and rival bid – withdrawal of application

Corporations Act 2001 (Cth): sections 610, 633(1) item 6, 636(1)(c), 636(1)(f), 636(1)(l), 659AA and 659B

Guidance Note 14 Funding arrangements in takeovers

Pendant Software Pty Ltd v Harwood [2006] FCA 717

Pinnacle VRB Ltd (No. 04) [2001] ATP 7

Pinnacle VRB Ltd (No. 06) [2001] ATP 11

McCann v Pendant Software Pty Ltd [2006] FCA 1129

Tower Software Engineering Pty Ltd, Equity Partners One Pty Ltd, Pendant Software Pty Ltd, Pendant Properties Pty Ltd, Mr Berend Hoff

These are the Panel's reasons for declining to make a declaration of unacceptable circumstances on an application by Mr Berend Hoff dated 1 August 2006 in relation to the affairs of Tower Software Engineering Pty Ltd (having received undertakings from Pendant Software Pty Ltd and Pendant Properties Pty Ltd) and its decision to later consent to Mr Hoff withdrawing his application.

THE PANEL AND PROCESS

1. The president of the Panel appointed Kevin McCann (sitting President), Norman O'Bryan SC (sitting Deputy President) and Chris Photakis as the sitting Panel (the **Panel**) for the proceedings (the **Proceedings**) arising from the application.
2. The Panel adopted the Panel's published procedural rules for the purpose of the Proceedings.
3. The Panel consented to the parties being legally represented by their commercial lawyers in the Proceedings.

SUMMARY

4. These reasons relate to an application (**Application**) to the Panel from Mr Berend Hoff on 25 May 2006 in relation to the affairs of Tower Software Engineering Pty Ltd (**Tower**).
5. The Application concerned a takeover offer by Pendant Software Pty Ltd (**Pendant Software**) for Tower (**Offer**).
6. The Offer provided that all Tower shareholders must first comply with the provisions in Rule 120 of Tower's constitution granting existing members a pre-emptive right to purchase shares offered for sale to non-members (**Pre-emptive**

Rights Regime). Prior to the Offer, the Pre-emptive Rights Regime had already been satisfied by one member, Equity Partners One Pty Ltd (**Equity Partners**). As no existing Tower shareholder had elected to acquire all of Equity Partners' shares under the Pre-Emptive Rights Regime, Equity Partners had a three month window within which to sell its shares to a non-member (such as the bidder).

7. In a meeting of the Tower board held on 18 April 2006, Mr Frederick John Frost, a director of both Tower and Pendant Software, advised that Pendant Software intended to make the Offer, and tabled a bidder's statement in relation to the Offer (**Bidder's Statement**). At the same meeting, the Tower board passed a resolution to dispense with the usual 14 day minimum period between giving a bidder's statement to the target and dispatching offers to target shareholders[1]. This allowed Pendant Software to send the offers and Bidder's Statement to Tower shareholders immediately.

8. If the Bidder's Statement had been dispatched in accordance with the normal 14 day timetable, Equity Partners' window within which it could accept the Offer (before having to re-comply with the Pre-emptive Rights Regime) would have expired. However, following the Tower board's decision to allow early dispatch, Equity Partners accepted the Offer on 19 April 2006.

9. In summary, the Panel considered that the Tower board's decision to consent to early dispatch, without having either undertaken a thorough review of the Bidder's Statement or sought appropriate legal advice in relation to it, would have justified a declaration of unacceptable circumstances (having regard to the effect of that decision on the acquisition by Pendant Software of Equity Partners' shares in Tower and on the control, or potential control, of Tower).

10. However, the Panel accepted undertakings (set out in Annexure A) which addressed its concerns and, accordingly, considered that it was not against the public interest to decline to make a declaration of unacceptable circumstances or orders.

11. The Panel later commenced proceedings in the Federal Court against Pendant Software seeking to enforce the undertakings, in accordance with the Panel's interpretation of those undertakings. Justice Finklestein held that Pendant Software had not breached the undertakings but, granted an extension of time for the Panel to make a declaration of unacceptable circumstances in relation to the Application.

12. Before the Tower 01 Panel proceedings were finally resolved the parties reached an agreement under which Pendant Software agreed to accept an increased rival offer by Quadrant Private Equity Pty Limited (**Quadrant**) for all of the Tower shares it held. The Panel considered that the agreement advanced the purposes of the Takeovers Chapter in the manner which it had intended when it accepted the undertakings from Pendant Software. On that basis, the Panel consented to Mr Hoff withdrawing the Application.

[1] The issue of who proposed the resolution was contested in the Panel's proceedings. It was either proposed by the Chairman of Tower or by the director representing Pendant Software, Mr Frost.

BACKGROUND

13. On 18 April 2006, Pendant Software gave the Bidder's Statement containing the Offer to Tower, and, on the basis of the decision of the Tower board to shorten the period for dispatch of the Offer, made the Offer for all in the shares in Tower at $1.45 per share the next day. The scheduled close of the Offer was 18 July 2006.

Tower

14. Tower was a proprietary company which had, at the time of the Application, approximately 124 shareholders, including 78 employees of Tower.

Major Shareholders

15. As at the date of the Application, the three major shareholders of Tower were Pendant Properties Pty Ltd (**Pendant Properties**) (30.54%), Mr Hoff (30.26%) and Equity Partners (14.43%). In total the three shareholders accounted for 75.23% of all Tower shares.

16. Each of the three major shareholders were represented on Tower's board as follows:

    (a) Pendant Properties Mr Frost;

    (b) Mr Hoff - Mr Hoff; and

    (c) Equity Partners - Mr Peter Johnson.

    The remaining members of the Tower board were Mr Service, Mr Harwood and Mr Schofield (the **Independent Directors**).

Pendant Software

17. Pendant Software was a proprietary company that had the same directors as Pendant Properties, namely Mr Frost and Mr Allan Trevor Whittenbury. The share capital of Pendant Software was also ultimately owned and controlled by Mr Frost and Mr Whittenbury, the same ultimate owners of Pendant Properties.

Pre-emptive rights regime

18. Under Rule 120 of Tower's constitution, existing shareholders had a pre-emptive right to purchase shares in Tower offered for sale to non-members. If no shareholder exercised its right to acquire those shares by the end of one month after being served with a transfer notice (**Pre-emption Period**), the selling shareholder could, within 3 months, sell those shares to a non-member (at a price no less favourable than that offered to the other shareholders).

Initial sale offer by Equity Partners

19. On 31 October 2005, a notice was sent to Tower shareholders in accordance with the Pre-emptive Rights Regime in relation to the sale of all of the Tower shares held by Equity Partners at $1.33 per share.

20. During the Pre-emption Period, Tower received legal advice that neither Pendant Properties nor Mr Hoff could purchase Equity Partners' Tower shares except through making a takeover bid. The Pre-emption Period expired and none of Equity Partners' Tower shares were purchased.

Relationship between Pendant Software and Equity Partners prior to the Offer

21. In the Application, Mr Hoff submitted that prior to the announcement of the Offer, Equity Partners had an agreement, arrangement or understanding with Pendant Software to sell its shares to Pendant Software.

22. When deciding whether to commence proceedings, the Panel considered that the material issue before it was the question whether the circumstances before it had had an effect on control, or potential control, of Tower, or the acquisition or proposed acquisition of a substantial interest in Tower, and if so, whether the acquisition of control over voting shares in Tower took place in an efficient, competitive and informed market. Having regard to the lapse of time, the Panel concluded that it did not need to decide whether, in October 2005, Pendant Software had acquired a relevant interest in the Tower shares held by Equity Partners (**Prior Acquisition**) or whether that Prior Acquisition (if it occurred) still had effect at the time of the Application. None of the parties objected in their submissions to the Panel taking that approach.

Second offer for sale by Equity Partners

23. On 1 January 2006[2], a further notice was sent to Tower shareholders in accordance with the Pre-emptive Rights Regime in relation to Equity Partners' Tower shares at $1.45 per share.

24. On 1 February 2006, the Pre-emption Period ended and Equity Partners became entitled under Tower's constitution to sell its Tower shares to non-shareholders until 1 May 2006.

Board meeting

25. At a Tower board meeting held on 18 April 2006 (**Board Meeting**):

    (a) Mr Frost tabled the Bidder's Statement; and

    (b) a motion was moved that Tower dispense with the minimum 14 day period normally statutorily required between giving a bidder's statement to the target and when the related offers and copies of the bidder's statement can be sent to target company shareholders (section 633(1) Item 6), to allow Pendant Software to send the offers and Bidder's Statement to shareholders[3] immediately (**early dispatch**).

26. Mr Hoff and the Independent Directors had not seen any draft of the Bidder's Statement prior to the Board Meeting. Most parties noted Mr Frost making amendments to the Bidder's Statement during the meeting.

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[2] This date was disputed by Equity Partners in a letter from Mr Peter Johnson dated 6 June 2006 in relation to the Proceedings. Mr Johnson asserted that the letter was sent on 9 January 2006. Originally, the notice was given to Tower on 23 December 2005, but Tower purported to take it that the notice was effectively given to it on 1 January 2006. However, the Panel did not consider that anything material turned on the difference between these dates.

[3] The Application stated that Mr Frost moved this motion. Equity Partners submitted that the chairman, Mr Service, had moved the motion.

27. The Independent Directors submitted that the Tower board considered the Bidder's Statement and listened to a briefing by Mr Frost in relation to the key terms of the Offer prior to the Board's decision. Mr Service also stated that he allowed time in the meeting for the directors to read the Bidder's Statement and that he checked with all directors that they had read the Bidder's Statement in full before continuing with the meeting. This was disputed by Mr Hoff who submitted that, while the Bidder's Statement was available after it was tabled, time was not given for directors to consider it before discussion on the next resolution took place. Mr Hoff submitted that the discussion on the terms of the Offer and the decision to dispense with the 14 days and allow early dispatch took less than 10 minutes.

28. The Independent Directors submitted that they did not recall there being any discussion at the Board Meeting of the fact that Equity Partners was the only shareholder who could immediately accept the Offer by virtue of it recently satisfying the Pre-emptive Rights Regime.

29. Following some discussion at the Board Meeting in relation to the to early distribution of the Bidder's Statement to shareholders, the board resolved[4] the following (**Board Resolution**):

> "The Board resolved, Brand [sic] Hoff dissenting, to acknowledge receipt of the Bidder's Statement and further resolved, without Bill Frost participating in the vote, to consent to the Bidder's Statement being sent by Pendant Software Pty Ltd to all Company shareholders and option holders as soon as Pendant Software Pty Ltd chooses, noting that this may be earlier than otherwise provided in the Corporations Act. The majority of the Directors were of the opinion that it was in the interests of Tower Software to consent to early distribution so that shareholders, and staff in particular, were as fully informed as practicable. Mr Frost declared his interest as a Director and shareholder in the Bidder."

30. Mr Hoff submitted that at the meeting he requested that Tower seek legal advice before agreeing to early dispatch, but Mr Service and Mr Harwood stated that they had no recollection of this (the minutes of the meeting had not been signed at the time of the Panel's Proceedings). Regardless, Tower did not obtain any legal or financial advice in respect of the Offer or the Bidder's Statement prior to consenting to early dispatch of the Bidder's Statement.

Equity Partners' acceptance of the Offer

31. By an acceptance and transfer form dated 19 April 2006 (**Equity Partners transfer**), Equity Partners accepted the Offer, and thereby increased Pendant Software's voting power in Tower to 44.97%.

Disclosure deficiencies

32. On 19 April 2006, Tower advised Pendant Software that there were some disclosure deficiencies in the Bidder's Statement.

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[4] Mr Service, Mr Harwood, Mr Schofield and Mr Johnson voted in favour of the resolution. Mr Hoff dissented. Mr Frost disclosed his interest as a director of Pendant Software and abstained from voting.

33. Between 19 and 20 April 2006, the Bidder's Statement and a supplementary bidder's statement (**Supplementary Bidder's Statement**), which corrected some errors in the Bidder's Statement, were distributed to Tower shareholders.

Legal Advice

34. Mr Hoff submitted, and Tower acknowledged, that on 20 April 2006, Tower obtained legal advice[5] from Mallesons Stephen Jaques that the minimum 14 day period under section 633(1) Item 6 should not have been waived by the Tower board.

35. On 1 May 2006, Tower sent a letter to shareholders advising them not to make a decision in relation to the Offer before reading the target's statement and the independent expert's report.

Registration of transfer

36. On 1 May 2006, Pendant Software, by notice to Tower, declared its Offer free from all conditions except the non-waivable condition concerning registration of transfers in clause 10.8 of the Bidder's Statement. Mr Frost also wrote to the chairman of Tower, Mr Service, requesting a board meeting of Tower for the directors to agree to register all acceptances in relation to the Offer received by Pendant Software.

37. The board meeting was held on 4 May 2006. At the meeting, the chairman tabled a letter from Quadrant in which Quadrant submitted a confidential, non-binding, proposal on behalf of funds advised by it to acquire an interest in Tower (on the basis of a 45% minimum acceptance and a recommendation by the directors), and set out in summary the proposal with an indicative price of $1.55 per share.

38. At the board meeting, a resolution to register the transfer of Equity Partners' shares to Pendant Software, and a resolution to register the transfer of acceptances of Equity Partners' offer, were defeated. Instead, a resolution was passed that Tower would register transfers of shares after the close of the Offer, on the condition that doing so would not involve a breach of the directors' duties and that there was no higher offer made for shares during the Offer period.

39. Mr Frost submitted that this was done to "keep the bid [the Pendant Software offer] alive and also encourage Quadrant to go ahead with their indicative bid".

40. On 17 May 2006, Tower dispatched its Target Statement to shareholders.[6]

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41. On 11 May 2006, Pendant Software obtained an interlocutory order from the Federal Court (without prejudice to any later order of the Court that the registration should not take effect) that the board resolve to register the transfer of Equity Partners' Shares to Pendant Software without conditions. These proceedings were ostensibly commenced to prevent the defeating condition at section 10.8 of the Pendant Software Offer being triggered and causing the offer to close with a defeating

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[5] This advice was not provided to the Panel in these Proceedings.

[6] Tower had sought, and obtained, relief from ASIC to dispatch its target's statement to its shareholders more than 15 days after the offers were sent. The Panel notes that, by consenting to early dispatch, Tower effectively reduced by two weeks the statutory period it had to prepare its target's statement and obtain an expert's report.

condition unmet. However, the status of the defeating conditions of the Pendant Software Offer at that date had not been ruled upon by the court.

42. On 2 June 2006, Pendant Software made an interlocutory application in the Federal Court to restrain Mr Hoff from taking any further step in the Proceedings before the Panel following Mr Hoff making the Application on 25 May 2006.

43. On 6 June 2006, Justice Goldberg gave judgment dismissing Pendant Software's application to the Federal Court. His Honour held that the integrity of the Offer as a whole was not before the Court. Goldberg J observed that, by virtue of sections 659AA and 659B, the Panel is the main forum for resolving disputes in relation to a takeover offer during the bid period. Goldberg J noted that Counsel for Pendant Software had emphasised that the application to the Panel sought an order that Equity Partners' acceptance be declared void. His Honour also observed that the Panel could make such a declaration, on the basis of unacceptable circumstances, for reasons not available to the Federal Court. Such a declaration would not impinge on the jurisdiction of the Federal Court. Goldberg J held:

> "*The consequence of the Panel's determination may be to remove the substratum of the basis for the registration of the transfer sought by Pendant Software, but this is not because the Panel is assuming the task of the Court or destroying the substratum of the matter before the Court. It is because there is a separate and independent basis for a challenge to the consequences of the carrying out and implementation of Pendant Software's takeover offer*".[7]

Circumstances

44. The Application sought a declaration of unacceptable circumstances in relation to the affairs of Tower in respect of:

    (a) the Board Resolution;

    (b) the acceptance by Pendant Software of Equity Partner's acceptance and notice of transfer of the Offer dated 19 April, 2006.

DISCUSSION

Disclosure

45. The Application, and the Bidder's Statement and Supplementary Bidder's Statement provided in support of the Application, revealed deficiencies in disclosure in the Bidder's Statement concerning the following:

    (a) the ownership of Pendant Properties and Pendant Software and their relationship / association;

    (b) Pendant Software's voting power in Tower;

    (c) Pendant Software's ability to fund the bid consideration and the sources of those funds;

    (d) Pendant Software's intentions under section 636(1)(c) in relation to Tower; and

[7] *Tower Software Engineering Pty Ltd; Pendant Software Pty Ltd v Harwood* [2006] FCA 717 at [44]

(e) the Pre-emptive Rights Regime.

46. Whilst the Panel considered that there may have been inadequate disclosure of the Prior Acquisition (if it had occurred), Pendant Software and Mr Hoff[8] accepted the position adopted in the Panel's brief, that it was unnecessary for the Panel to decide whether the Prior Acquisition had in fact occurred. Further, no evidence was presented by the parties which proved the Prior Acquisition. Accordingly, the Panel made no findings in relation to whether or not there was adequate disclosure in relation to any Prior Acquisition.

Association, voting power, relevant interests

47. Section 8.1 of the Bidder's Statement (as replaced by the Supplementary Bidder's Statement) stated that:

> *As at the date of the Bidder's Statement:*
>
> *(a) Pendant [Software] does not own any shares in Tower Software but by virtue of its association with Pendant Properties Pty Ltd should Pendant [Software] acquire shares in Tower Software Engineering Pty Ltd the directors will have a relevant interest in 9,521,000 shares (30.54%) plus any shares acquired by Pendant [Software].*
>
> *(b) Pendant [Software] has no voting power in Tower Software as it does not own any shares in Tower Software but by virtue of its association with Pendant Properties Pty Ltd should Pendant [Software] acquire shares in Tower Software, Pendant [Software's] voting power will be 9,521,000 votes (30.54%) plus one vote for every share acquired by Pendant [Software].*

48. Section 4 of the Bidder's Statement stated:

> *Pendant Software Pty Ltd … is an associate company of Pendant Properties Pty Ltd…*

49. Section 5 of the Bidder's Statement stated:

> *5.1 Current Shareholders*
>
> *Pendant Realty Pty Ltd…*
>
> *…*
>
> *A.T. Whittenbury & Coy Proprietary Limited …*
>
> *5.3 Overview*
>
> *Pendant Software … has the same directors as Pendant Properties … the largest shareholder of Tower Software … Because Pendant Software … has the same directors as Pendant Properties ... under the Corporations Act these companies are deemed to have a relevant interest in each other. As the relevant interest exceeds 20% of the voting shares in [Tower Software] neither of the companies are allowed to acquire more than 3% of Tower Software … in any six month period unless a takeover bid … is made.*

50. Section 8.1 of the Bidder's Statement stated:

> *As at the date of this Bidder's Statement:*

[8] Tower did not address this issue in its Panel submission.

(a) Pendant [Software] does not own any shares in Tower Software but by virtue of its association with Pendant Properties Pty Ltd and common directorships has a relevant interest in 9,521,000 (30.54%) of Tower Software shares.

(b) Pendant [Software] has no voting power in Tower Software.

51. It appeared to the Panel that both Pendant Software and Pendant Properties must have had the same voting power from the time that they became associates (such association presumably arising under section 12(2)(c) – by virtue of the companies acting in concert in relation to the affairs of Tower, although Pendant Software did not clearly set out the basis of association). This was the case because, under section 610, a person's voting power is measured by aggregating the person's relevant interests with the relevant interests of their associates. Section 8.1 of the bidder's statement (as replaced by the Supplementary Bidder's Statement) appeared to suggest that the directors of Pendant Software would have a relevant interest in the Tower shares held by Pendant Properties, but that Pendant Software would only have voting power in those shares. The Panel considered that, if this was the case, a subsequent transfer of Tower shares between Pendant Properties and Pendant Software (or vice versa) may have resulted in a deemed change in voting power under section 610(3). Accordingly, the Panel considered that Pendant Software should have clarified whether it had a relevant interest in Tower shares held by Pendant Properties and, if so, the nature of that interest (eg power to vote, power to dispose etc) and when and by what agreements or understandings it was created.

52. Whilst the disclosure in relation to voting power appeared to the Panel to be incorrect, the parties accepted that Pendant Properties and Pendant Software were "one-and-the-same" (that is, for all intents and purposes, the parties appeared to accept that the bidder effectively had a 30% interest in Tower). There was no evidence to suggest that shareholders were misled by the incorrect disclosure. Accordingly, whilst there appeared to have been a breach of section 636(1)(l), the Panel considered that it would not be in the public interest to make a declaration of unacceptable circumstances provided Pendant Software made the additional disclosure referred to in paragraph 51.

Offer Funding

53. Section 5.4 of the Bidder's Statement stated:

> *[T]he maximum cash amount payable which may be required to settle acceptances under the Offer is approximately $33 million.*
>
> *The Bidder does not hold any cash amounts at the date of the announcement of the Bid. The shareholders of the Bidder have undertaken to provide 100% of the funds required by the Bidder to complete the bid and will subscribe cash for shares in equal proportion in the Bidder company. No external finance is required to fund the Bid.*

54. The Application alleged that the Bidder's Statement failed to comply with section 636(1)(f)(ii) and (iii) of the Act. The Application noted that company searches of the shareholders of Pendant Software revealed that:

- Pendant Realty Pty Ltd had paid up capital of $2; and
- A.T. Whittenbury & Coy Proprietary Limited had paid up capital of $114,466.

55. The Applicant contended that these companies did not have evident capacity to complete the obligations of Pendant Software under the Offer.

56. In its submissions, Pendant Software contended that:

> *[it] has the resources available to fully fund its obligations under the offer. This has been confirmed by WHK Smith Reed [it was submitted that WHK Smith Reed is Pendant Software's accountant].*

57. Pendant Software further noted that:

> *If the Panel concludes that there has been a failure to comply with Guidance Note 14 [Funding Arrangements in Takeovers] … Pendant Software undertakes to make such disclosure if so required.*

58. Section 636(1)(f) of the Act requires bidders to disclose details of:

(i) the cash amounts (if any) held by the bidder for payment of the consideration;

(ii) the identity of any other person who is to provide, directly or indirectly, cash consideration from that person's own funds; and

(iii) any arrangements under which cash will be provided by a person referred to in sub-paragraph (ii).

59. The Panel has released guidance (Guidance Note 14) which discusses when the funding arrangements for the cash component of the consideration for a takeover bid may give rise to unacceptable circumstances. The Note also gives some guidance as to disclosure issues associated with the funding of a bid. Whilst Guidance Note 14 focuses on debt facilities used to fund a bidder's obligations under a bid, it also states that the principles apply equally to funding out of a bidder's own resources.

60. The Guidance Note provides:[9]

> *The bidder must disclose in its bidder's statement or other disclosure documents, in meaningful and clear language, the nature and details of its funding arrangements…*

61. Furthermore, the Guidance Note states[10]:

> *If the bidder's funding is being provided by or through a member of the same corporate group, the arrangements for this should be binding on all parties … and fully documented.*
>
> *…*
>
> *The terms of these intra-group arrangements should be disclosed to the extent that they are relevant to the availability of the funding in the bidder's statement.*

62. In *Pinnacle VRB Ltd (No. 04)* (**Pinnacle 04**) the Panel found that while the bidder (Reliable) could demonstrate that its financier (New West) had committed to provide funds to pay for acceptances, it could not demonstrate that New West had access to sufficient funds for that purpose. This lead to a declaration of unacceptable circumstances and orders cancelling the bid since:

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[9] In the "Disclosure Note" to paragraph [14.4]

[10] At paragraph [14.20]

- New West was a private and foreign company and accordingly, the Panel had no means of obtaining its own evidence to be sufficiently assured that it had access to the funds required for the bid;

- whilst Reliable directors may have believed that New West would meet its commitment to provide the funds, the terms on which the funds would be provided had not been decided, not even whether it would be equity or a loan. This lack of definite arrangements gave rise to doubt as to whether funds would be provided as well as the terms on which they would be provided;

- the scope for such doubt raised the possibility of disruption to the efficient, competitive and informed market in the target's shares; and

- target shareholders did not have enough information to enable them to assess the merits of Reliable's offer.[11]

63. The Panel considered that Pendant Software's disclosure in relation to its bid funding was inadequate because it failed to identify the person(s) ultimately responsible for providing those funds (Pendant Software later stated in its submissions that WHK Smith Reed would confirm that Pendant Software had the resources to meet all of its obligations) and the arrangements under which those funds would be provided.

64. The Panel accepted an undertaking from Pendant Software to provide additional disclosure in relation to its funding arrangements and accordingly, the Panel did not consider it necessary to make a determination of whether there were unacceptable circumstances in relation to Offer funding.

Pre-emptive Rights Regime

65. Section 6.2 of the Bidder's Statement stated:

> *The Target's constitution has certain provisions (Rule 120 of the Target's constitution) relating to shareholders Pre-emptive Rights which will require shareholders who decide to accept the Bidder's offer to firstly offer their shares to all of the Target's existing shareholders in accordance with the provisions of the Target's constitution.*
>
> *Accordingly shareholders who want to accept the bid will be required firstly to offer their shares to existing shareholders of Tower Software and then accept the Offer by the Bidder for all the balance of the shares you still own.*

66. Pendant Software contended that the Pre-emptive Rights Regime was fully detailed in the annexure to the Bidder's Statement. Tower submitted that to the extent there were material deficiencies in the Bidder's Statement these were addressed in Tower's target's statement and supplementary target's statements.

67. Pendant Software submitted that the Pre-emptive Rights Regime did not apply to transfers of shares between members. Pendant Software submitted that if Equity Partners' transfer had been registered when presented to the Tower board on 4 May

[11] Note that the interim and final orders made by the Panel in Pinnacle 04 were subsequently revoked by the Panel in Pinnacle VRB Ltd (No. 6) following the bidder being able to demonstrate that it had funds available to meet its commitment under the bid and making further disclosure to this effect.

2006 there would have been no need for other shareholders wishing to accept the Pendant Software offer, to comply with the Pre-emptive Rights Regime (as the transfer would then have been one between "member and member" and exempt from the Pre-emptive Rights Regime). This was not disputed in the Target's Statement. Although it was initially submitted on behalf of Mr Hoff that an earlier amendment of the Tower constitution imposed limits on transfers between members[12], all parties ultimately accepted that the amendment had not been made.

Disclosure of right to immediately accept

68. The Panel asked the parties:

    (a) whether Pendant Software should have disclosed, in the Bidder's Statement, Equity Partners' right to immediately accept the Offer (without having to re-comply with the Pre-emptive Rights Regime); and

    (b) what effect such disclosure would have, or would likely have, on the decisions of Tower shareholders whether or not to accept the Pendant Software Offer.

69. Pendant Software submitted that, at the date the Bidder's Statement was served, it[13] "was not in a position to know that Equity Partners would accept the offer…". This response did not address the question that the Panel put to the parties – namely, whether the right to accept immediately should have been disclosed. In relation to the second question, Pendant Software submitted that as no other shareholders had yet accepted the Offer, there was no effect on decisions of Tower shareholders whether or not to accept the Offer.

70. Tower only responded in relation to the second question, submitting that it did not believe such disclosure would have had any material effect on decisions of Tower shareholders whether or not to accept the Offer.

71. The Panel considered that the Bidder's Statement should have disclosed Equity Partners' right to immediately accept the bid if the Bidder's statement was lodged with ASIC after Tower gave its consent to early dispatch (which resulted in Equity Partners' immediate right to accept the Offer). If the Bidder's Statement was lodged with ASIC prior to Tower giving its consent to early dispatch then such disclosure could have been made in the Supplementary Bidder's Statement. The Panel noted that the copy of the Bidder's Statement on ASIC's database includes handwritten amendments that appear to be those made at the Board Meeting, which suggested to the Panel that the Bidder's Statement was lodged with ASIC after the Board Meeting.

Early dispatch of Bidder's Statement

72. Item 6 of section 633(1) has the effect of preventing a bidder from sending its offer to shareholders earlier than 14 days after it has been given to the target unless the directors of the target agree to earlier dispatch. In *BreakFree Ltd (No 2)* [2003] ATP 30 at [7] the Panel commented that this provision:

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[12] Mr Hoff came to this conclusion because of an incorrect copy of the Tower constitution attached as an exhibit to an affidavit by Mr Frost in Proceedings VID496 of 2006.

[13] Note that the submission erroneously referred to "Pendant Properties".

> *"…exists to afford the board of the target company a reasonable period of time to assess and react to the bid, relevantly including preparing a target's statement, requesting changes to the bidder's statement and offers and deciding whether to seek orders restraining dispatch of the offers.*

73. Where target directors agree to early dispatch of a bidder's statement without allowing themselves any meaningful opportunity to consider the document (or a near final draft) and without having obtained appropriate advice concerning its content and effect, there is a risk that the policy behind item 6 of section 633(1), namely that the target company has at least a 14 day period to consider the offer and the bidder's statement, will be undermined. If so, the adequacy of the information provided to the market and target shareholders is likely to suffer, contrary to the policy behind paragraphs (a) and (b)(iii) of section 602, as a result of target directors failing to avail themselves of the opportunity provided by item 6 of section 633(1) to ensure that the market and target shareholders are properly informed. Further, the effect of early dispatch in this case was to enable a substantial level of control (if not actual control) to pass without any opportunity for a competing bid to be contemplated, let alone made. That is contrary to a fundamental precept of the legislative policy that informs Australian takeover law: that takeovers occur in efficient, competitive and informed markets.

74. It was clear on the material before the Panel that, in this case, at the time the Tower board agreed to early dispatch, the board:

    (a) had not seen a draft of the Bidder's Statement before the meeting;

    (b) had, at the most, time to read the Bidder's Statement at the meeting, but only very limited opportunity to consider its content;

    (c) had not sought or obtained any legal or other advice on the content of the Bidder's Statement, in particular, whether it complied with the disclosure requirements of sub-section 633(1); and

    (d) had not sought or obtained any legal or other advice on the issue of whether it was appropriate to consent to early dispatch under sub-section 633(1) Item 6.

75. Mr Hoff submitted that he had requested that Tower seek legal advice before agreeing to early dispatch. However, Mr Service and Mr Harwood maintained that they had no recollection of this request. Regardless of whether Mr Hoff's request was made (or heard by other directors), it is clear that the board did not seek legal or other advice before making the decision.

76. The Panel considered that, given the Bidder's Statement had not been properly reviewed from Tower's perspective by any person, the Tower directors should have considered seeking advice before agreeing to early dispatch. Tower submitted that its directors had substantial experience as company directors and that they were well placed to form their own views. However, the Panel considered that, even assuming such experience (and Tower gave no evidence that the experience of any of the Tower directors extended to takeovers situations), there was insufficient time for the directors to form properly considered views on the issue of consent to early dispatch.

77. In addition, the Panel thought it likely that, if the Tower board had sought legal advice, some of the deficiencies in the Bidder's Statement discussed above would

have been appreciated and could have been corrected. The board may also have been advised that it could have difficulty obtaining an expert's report before the deadline for sending the Target's Statement, and may have declined to agree to early dispatch for that reason alone.[14]

78. Accordingly, the Panel considered that the decision of the Tower directors to consent to early dispatch, without having either undertaken a thorough review of the bidder's statement or sought appropriate legal or other advice, would need to be supported by compelling reasons[15] to be consistent with paragraphs (a) and (b)(iii) of section 602.

79. Tower submitted that the Tower board's consent to early dispatch did not constitute unacceptable circumstances, on the basis that:

    (a) the Act expressly provides for early dispatch and contemplates that there will be circumstances in which it is appropriate;

    (b) as the majority of Tower shareholders are employees or ex-employees, Tower considered it important that they receive as much information as possible as quickly as possible so as to reduce the possibility of rumours and impact on Tower's business; and

    (c) the Pre-emptive Rights Regime meant that shareholders would not be in a position to accept until after they had received the Target's Statement and accompanying independent expert's report.

80. The Panel considered that the matters enumerated above did not provide adequate justification for the Tower board's decision:

    (a) The fact that the Act permits early dispatch does not mean that it is appropriate for directors to agree to that course of action without having undertaken any proper review of the bidder's statement.

    (b) The Panel accepted that the unusual nature of Tower (as a proprietary company with numerous employee shareholders) may warrant some differences in approach than would be required of a listed target. However, the Panel considered that there were alternatives which could have allowed the board to meet its objectives without precluding proper consideration to the bidder's statement. (For example, the board could have passed on the information likely to be of most interest to shareholders in a letter and employee shareholders by email or a hand delivered letter. Likewise, the directors could have provided a copy of the bidder's statement (by then a public document) to the relatively small number of Tower shareholders, once it had been corrected, without any need to consent to early dispatch.

    (c) The Pre-emptive Rights Regime did not, in the circumstances, prevent Equity Partners from accepting immediately. Furthermore it appeared that, on Pendant Software's interpretation of the regime at least (which Tower also

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[14] The Panel noted that, if the Tower board had not agreed to early dispatch, it may not have needed to seek the ASIC relief described in paragraph 8.11 of the Target's Statement. See footnote 6 above.

[15] An example of such compelling reasons might be where offers need to be dispatched to allow them to be considered at the same time as an earlier competing offer. See: *Re Taipan Resources (No 8)* [2001] ATP 3.

adopted, although its initial submissions and reasons for consenting to early dispatch appeared inconsistent with that interpretation), early registration of a transfer from Equity Partners would have meant that other shareholders would not need to comply with the regime. Therefore, the Tower board's assertion that shareholders would not have been in a position to accept until after shareholders had received the Target's Statement and accompanying independent expert's report, was inconsistent with its decision to consent to early dispatch.

81. If it had not been for the Tower board's decision to agree to early dispatch, Equity Partners would not have been able to accept the Pendant Software Offer without giving a further notice under Rule 120, regardless of which view was correct as to when its Pre-emption Period ended. It follows that the circumstances (being the Tower board's decision to consent to early dispatch) had the direct effect of enabling Pendant Software to acquire a relevant interest in Equity Partners' shares in Tower which clearly constituted a substantial interest.

82. The material presented to the Panel did not support the view that Equity Partners would necessarily have accepted the Offer a month later, after giving a further pre-emption notice. By that time Equity Partners would have received the independent expert's report advising that the offer price of $1.45 "does not include a premium for control and shareholders should seek to obtain a higher price for control of Tower". Equity Partners' nominee on the Tower board would also have been informed of the "non-binding proposal" at an "indicative" price of $1.55 from Quadrant. Assuming that there were no special circumstances, and no agreement or understanding by Equity Partners to sell to Pendant Software (such as the Applicant submitted should be inferred), the Panel considered that those developments alone would be likely to cause a reasonable investor in Equity Partners' position to reconsider its position, even if there was no competing offer. Furthermore, Equity Partners informed the Panel that its decision would have been based on the circumstances as they existed at the relevant time.

83. The Panel considered that the Tower board's decision to agree to early dispatch also had an effect on control of Tower in that it enabled Pendant Software to move from voting power in Tower of 30% to 45% on 19 April 2006. The Panel considered that this was likely to give Pendant Software at least a substantial degree of control over Tower and its operations.

84. Tower submitted that voting power of 45% would not provide effective control in all relevant senses, because voting power of 45% would not allow the holder to change Tower's constitution or initiate a sale or initial public offering of Tower or its assets, and because Tower's constitution bears the hallmarks of a closely held private company. The Panel noted that, although rule 6.2 of Tower's constitution allows a "major shareholder" to appoint 1 director, rule 6.1 allows the company in general meeting to appoint up to a maximum of 7 directors (and this limit can be increased by the company in general meeting under rule 4.2). Consequently it appeared to the Panel that a shareholder of Tower who can pass an ordinary resolution in general meeting will have a substantial degree of control. The Panel noted further that, although Tower is a proprietary company, it has significantly more than 50 members,

which is the criterion adopted by the legislature to determine when a company is sufficiently "widely held" to attract the operation of Chapter 6.

DECISION

85. The Panel considered that it would have been in the public interest to make a declaration of unacceptable circumstances in relation to the Tower board's decision to consent to early dispatch in the particular circumstances of these Proceedings having regard to the effect of that decision on the acquisition by Pendant Software of Equity Partners' shares in Tower, and on the control, or potential control, of Tower.

86. The Panel considered that a declaration would have been in the public interest, in the light of the effect on the efficient, competitive and informed market for voting shares in Tower, regardless of whether any of Pendant Software, Equity Partners or any Tower director knew or intended that allowing early dispatch would result in or enable immediate acceptance by Equity Partners. If any director of Pendant Software, Equity Partners or Tower did have such knowledge or intentions, that might well have provided other bases for a declaration, and may have been relevant to the Panel's consideration of what, if any, orders to make. The Panel noted that the Tower directors and Equity Partners did not provide statements to establish that they had no such knowledge or intention. However, Pendant Software and Frost denied they had such knowledge or intentions.

87. The Panel advised the parties that it was prepared to consider undertakings from Pendant Software (and Pendant Properties) that would address the unacceptable circumstances arising from the decision to consent to early dispatch and ensure an efficient, competitive and informed market for control of Tower.

Panel's acceptance of the Undertakings

88. Following the receipt of further submissions from the parties, Pendant Software agreed:

    (a) to give the undertakings described in Annexure A; and

    (b) to cause Pendant Properties to provide the undertaking described in Annexure A

    (the **Undertakings**).

89. Mr Hoff submitted that the Undertakings would allow Pendant Software and Equity Partners to benefit from the unacceptable circumstances and to maintain the loss by shareholders of their pre-emptive rights. Mr Hoff added that he was prepared to buy shares offered by Equity Partners under the Pre-emptive Rights Regime and should be given that opportunity.

90. Pendant Software noted that Mr Hoff could not acquire more than 3% of all Tower shares on issue unless he made a takeover bid under Chapter 6 of the Act and that Equity Partners could not be required and would be unwilling to sell some (but not all) of its shares to Mr Hoff under the Pre-emptive Rights Regime.

91. Equity Partners opposed alternative undertakings proposed by Hoff, contending that they sought to circumvent the Pre-emptive Rights Regime by allowing Hoff to acquire some (rather than all) of its shares and thereby acquire up to 3% without

having to make a takeover offer. Equity Partners confirmed that it would only be prepared to transfer its shares if all of its shares were accepted at the same time.

92. The Panel considered that had it not been for the Tower board's decision to consent to early dispatch, Equity Partners would have been unable to accept the Offer without giving a further pre-emption notice. Accordingly, there would have been at least one month in which a potential rival bidder could have made a bid and had a viable prospect of acquiring control. The truncating of the time that would otherwise have been available to a competitive bidder to make a bid for control of Tower was the fundamental reason for the Panel's concerns in this matter. The Panel considered that the Undertakings provided an equivalent opportunity for a potential rival bidder to make a takeover bid and acquire the Equity Partners' shares if Pendant Software did not match the rival bid. Accordingly, in these circumstances, the Panel considered that the Undertakings were sufficient to address the unacceptable circumstances arising from the decision to consent to early dispatch and to ensure that there was an efficient, competitive and informed market for control of Tower.

93. The Panel did not consider it appropriate to require, as submitted by Mr Hoff, that Tower shareholders be given the opportunity to buy Equity Partners' shares under the Pre-emptive Rights Regime. It is not a purpose of Chapter 6 to require that shareholders be given the opportunity to exercise pre-emptive rights created by the private means of a company's constitution. Even if it was, the Tower shareholders (including Mr Hoff) all had adequate opportunity (as a result of the notice sent by Equity Partners to shareholders in January 2006) but did not seek to take advantage of it.

94. The Panel further noted that it appeared unlikely that Mr Hoff would be able to acquire any of Equity Partners' shares without making a takeover bid. Accordingly, the Panel thought it was doubtful whether the orders and alternative undertakings sought by Mr Hoff would, as a practical matter, have achieved anything more than the Undertakings.

95. The Panel wrote to parties on 15 June 2006 advising that it had decided to accept the Undertakings for the reasons set out above. The Panel issued a media release on the same day which described its decision and attached the terms of the Undertakings.[16]

New bid

96. Subsequent to the Panel accepting the Undertakings, Quadrant made a conditional takeover bid, at $1.60 per share, for all Tower shares, which was sent to Tower shareholders on 14 July 2006 i.e. within the period set in the Undertakings for a bid to be made and to meet the first test under the Undertakings.

97. On 21 July 2006, Pendant Software increased its bid consideration to $1.60 per share. On the same day, Quadrant increased its bid consideration to $1.80 per share. On 27 July 2006, Quadrant declared its bid free of all defeating conditions i.e. within the period set in the Undertakings for a bid to be declared free of all defeating conditions and thus to meet the second test under the Undertakings.

[16] See Panel Media release TP 06-61.

98. Pendant Software considered that it had complied with the Undertakings by increasing its Offer to $1.60. In the Panel's view, the Undertakings required Pendant Software to match Quadrant's $1.80 bid (so as to be at least equal to the amount offered at the time Quadrant's bid became a "Superior bid") or accept into that bid in respect of the Equity Partners' shares.

99. The Panel applied to the Federal Court[17] to enforce the Undertakings, in accordance with its interpretation of the Undertakings or, alternatively, to seek an extension of time under section 657B to make a declaration of unacceptable circumstances on the basis of the Application. Justice Finkelstein held that Pendant Software had not breached its Undertakings to the Panel. However, his Honour granted an extension of time until Tuesday 5 September 2006 for the Panel to make a declaration of unacceptable circumstances in relation to the Application.

Resolution

100. On 25 August 2006, Quadrant reached agreement with Pendant Software that Pendant Software and its associates would accept the Quadrant bid for all the Tower shares they held, subject to clearing those shares through Tower's Pre-emptive Rights Regime and Quadrant increasing the consideration offered under its bid to $1.87. Quadrant advised Tower shareholders that it would increase its takeover offer consideration to $1.87 if it acquired more than 50% of the shares in Tower.

Consent to withdraw

101. On 28 August 2006, Mr Hoff requested the Panel's consent to withdraw the Application, on the basis that no useful purpose would be served by continuing the proceedings. Mr Hoff's request was either supported, or not opposed, by each of Quadrant, Tower and Pendant Software.

102. The Panel considered that it would not be in the public interest to continue the proceedings. The Panel noted that its primary concern in relation to the unacceptable circumstances identified in its decision on 15 June 2006[18] was to ensure an equivalent opportunity for a potential rival bidder to make a takeover bid and acquire the Equity Partners' shares if Pendant Software did not match that rival bid. This was consistent with the Panel's interpretation of the Undertakings. The Panel considered that the increased offer made by Quadrant, and Pendant Software's agreement to accept, achieved this objective and resulted in the acquisition of control of Tower taking place in an efficient, competitive and informed market. Accordingly, the Panel consented to withdrawal of the Application.[19]

Orders

103. As the Panel did not make a declaration of unacceptable circumstances, the Panel made no orders for costs or otherwise.

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[17] See *McCann v Pendant Software Pty Ltd (2006) FCA 1129*.
[18] See above at paragraph 95.
[19] See Panel Media release TP06/80.

Kevin McCann
President of the Sitting Panel
Decision dated 15 June 2006, consent to withdraw dated 1 September 2006
Reasons published 9 November 2006

Annexure A – Undertakings

In the matter of Tower Software Engineering Pty Ltd

Pursuant to section 201A of the Australian Securities & Investment Commissions Act 2001 (Cth):

Pendant Software undertakes that:

A. *It will not re-present the Equity Partners transfer for registration or otherwise seek to become a member of Tower before 14 July 2006.*

B. *It will present the Equity Partners transfer to Tower for registration before 5.00pm on 14 July 2006.*

C. *It will extend the offer period for its Offers so that it expires no earlier than 5.00pm on 25 July 2006.*

D. *If offers under a takeover bid for all Tower shares which offer cash of more than $1.45 per Tower share:*

(a) are sent to Tower shareholders on or before 14 July 2006; and

*(b) become free of all defeating conditions on or before 28 July 2006; (**Superior bid**),*

Pendant Software will, within 5 business days, either:

(c) increase the consideration offered under its offer to be at least equal to that offered under the Superior bid; or

(d) (i) (if the Superior bid is not made by a member of Tower) give a notice in writing to Tower in accordance with Rule 120.2 of the constitution of Tower offering to sell all of the shares the subject of the Equity Partners transfer at a price per share not higher than the price offered in the Superior bid and (unless such shares are acquired by other members under the Pre-emptive Rights Regime) accept the Superior bid for all Tower shares transferred to it by Equity Partners and not acquired by other members under the Pre-emptive Rights Regime. Such acceptance shall be made forthwith upon the expiry of the 1 month period referred to in Rule 120.6 of the constitution of Tower; or

(ii) (if the Superior bid is made by a member of Tower) accept the Superior bid for all Tower shares transferred to it by Equity Partners (or to which the Equity Partners transfer relates).

Pendant Software also undertakes to provide further disclosure in relation to its Offer funding in a supplementary bidder's statement.

Pendant Properties undertakes that:

If Pendant Software gives a notice in writing to Tower in accordance with Rule 120.2 of the constitution of Tower offering to sell all of the shares the subject of the Equity Partners transfer, Pendant Properties will not purchase any of those shares.