



In the matter of Queensland Gas Company Limited
[2006] ATP 36

Catchwords:

Basis for target directors' recommendation to reject takeover offer – inclusion of technical expert's report – independent expert's report – valuation of target – information deficiencies – supplementary target's statement – presentation and format of graphs and charts

Corporations Act 2001 (Cth) section 602(b)(iii), 638

ASIC Policy Statement 74, 75 ASIC Practice Notes 42, 43

Goodman Fielder Limited (No.2) [2003] ATP 05

Santos CSG Pty Ltd, Queensland Gas Company Limited

These are the Panel's reasons for declining to make a declaration of unacceptable circumstances in relation to an application by Santos CSG Pty Ltd dated 20 November 2006 in relation to its off-market takeover bid for Queensland Gas Company Limited.

THE PROCEEDINGS

1. These reasons relate to an application (the **Application**) to the Panel from Santos CSG Pty Ltd (**Santos**), a wholly owned subsidiary of Santos Limited, on 20 November 2006 in relation to its takeover offer for all the shares in Queensland Gas Company Limited (**QGC**). The Application was made under section 657A of the Corporations Act 2001 (*Cth*) (**Act**)¹.

SUMMARY

2. Santos applied for a declaration of unacceptable circumstances and final orders in relation to the target's statement (**QGC Target's Statement**) issued by QGC in response to an off-market takeover offer (**Offer**) by Santos for all of the ordinary shares in QGC.
3. Santos submitted that the QGC Target's Statement contained a number of deficiencies, in that, in summary:
 - (a) it failed to provide sufficient information to enable QGC shareholders to properly assess the merits of the Offer relative to the merits of remaining as shareholders in QGC;
 - (b) it contained insufficient information to support the conclusion of QGC's directors that the Offer was "opportunistic and patently inadequate" and should be rejected;
 - (c) it did not contain a report on QGC's reserves position which QGC had commissioned and had been prepared by a technical expert; and
 - (d) it contained other misleading or deceptive statements.
4. On 5 December 2006, QGC published statements on ASX (**5 December Announcement**) which announced a proposed transaction with AGL Energy Ltd

¹ Unless otherwise specified, statutory references are to provisions of the Corporations Act (2001) *Cth*.

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(AGL Proposal)² and a proposed transaction with Sentient Gas³ (Sentient Proposal) (collectively, the Proposals) which were subject to the approval of QGC shareholders at a meeting proposed for February 2007. The Panel considered that the Proposals (in particular, the AGL Proposal) and the Santos takeover bid were mutually exclusive transactions and QGC shareholders faced a clear choice between them.

5. The Panel considered that QGC's directors would have an obligation to provide proper disclosure about the Proposals and the basis of their recommendations for those Proposals in the notice of meeting and explanatory memorandum for those Proposals.
6. QGC advised the Panel that it had appointed Deloitte Corporate Finance Pty Ltd (Deloitte) to prepare an independent expert's report to accompany the notice of meeting and explanatory memorandum, advising whether, in Deloitte's opinion, the AGL Proposal was fair and reasonable to QGC shareholders. The Panel also considered that these documents should give QGC shareholders sufficient information to be able to assess:
 - (a) the value of QGC shares on a stand alone basis; and
 - (b) the relative merits and demerits of Santos' Offer and the AGL Proposal, and information to assist them to assess the Sentient Proposal.
7. The Panel did not consider that QGC shareholders would be materially assisted by receiving further information in the form of another supplementary target's statement explaining only the basis of QGC's directors' recommendation in relation to the Offer.
8. QGC offered to provide a supplementary target's statement to address a number of issues raised by the Panel which were the subject of the Application and to include the disclosures it had previously offered in relation to a number of issues raised by Santos.
9. Having regard to the further disclosures agreed to be provided by QGC in a second supplementary target's statement, the recent announcements by QGC about the Proposals, the further information to be provided in the notice of meeting and explanatory memorandum for the Proposals and submissions from QGC and Santos, the Panel decided not to make a declaration of unacceptable circumstances in relation to the Application.

The Panel & Process

10. The President of the Panel appointed Meredith Hellicar, Norman O'Bryan SC (sitting President), and Simon Withers as the sitting Panel (the Panel) for the proceedings (the Proceedings) arising from the Application.
11. The Panel adopted the Panel's published procedural rules for the purposes of the Proceedings.

² As described in QGC's Media Release dated 05/12/06 and QGC's first supplementary target's statement dated 07/12/06.

³ Sentient Gas is constituted by a number of entities which are part of the Sentient Global Resources Funds which are managed by the Sentient Group, an independent private equity investment firm specialising in the global resources industry <http://www.thesentientgroup.com/index.html>.

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12. The Panel consented to the parties being legally represented by their lawyers in the Proceedings.

APPLICATION

Background

13. On 5 October 2006, Santos made an announcement to ASX Limited (**ASX**) in relation to its off-market takeover offer for all the shares in QGC. On 10 October 2006, Santos issued a bidder's statement in relation to its Offer. Santos offered QGC shareholders \$1.26 for each of their QGC shares.
14. On 2 November 2006, QGC announced to ASX that it had been granted an extension by the Australian Securities and Investments Commission (**ASIC**) of the deadline for issuing the QGC Target's Statement. QGC's announcement noted that the extension had been granted to allow the expert, Netherland Sewell & Associates Inc. (**NSAI**), to finalise an independent certification of QGC's gas reserves. QGC's announcement noted that "[t]he results of NSAI's review will be incorporated into QGC's target's statement."
15. On 15 October 2006, QGC issued the QGC Target's Statement. In the QGC Target's Statement, QGC's directors declared Santos's Offer to be "opportunistic and patently inadequate" and recommended that QGC shareholders reject the Offer.
16. Santos submitted that the QGC Target's Statement contained a number of deficiencies in that, in summary:
 - (a) it failed to provide sufficient information to enable QGC shareholders to properly assess the merits of the Offer relative to the merits of remaining as shareholders in QGC;
 - (b) it contained insufficient information to support the conclusion of QGC's directors that the Offer was "opportunistic and patently inadequate" and should be rejected;
 - (c) it did not contain a report on QGC's reserves position which QGC had commissioned and which had been prepared by NSAI of November 2006 (**NSAI Report**), the key results of which were included in the QGC Target's Statement; and
 - (d) it contained other misleading or deceptive statements (**Disclosure Issues**).
17. Santos also raised a number of other issues in the Application which were addressed in correspondence between the parties which was copied to the Panel. These included:
 - (a) the economic certification of QGC's reserves upgrade set out in the NSAI Report. This was conducted by NSAI and the results of that economic certification were announced to ASX on 1 December 2006;
 - (b) a statement about the nature of the various forward-looking statements contained in the QGC Target's Statement (located on the inside front cover of the QGC Target's Statement);
 - (c) disclosure about one of the QGC's director's interests as the chairman of ABN AMRO Morgans, which had been engaged to advise QGC on its defence to the Santos Offer;

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- (d) disclosure about the incurrance of tax liabilities; and
- (e) disclosure about the important risks associated with QGC's business.

The above issues were addressed in QGC's second supplementary target's statement.

Declaration and orders sought in the Application

18. Under section 657A, Santos sought a declaration of unacceptable circumstances in relation to the deficiencies it identified in the QGC Target's Statement and final orders under section 657D that, in summary:
 - (a) QGC make an announcement to ASX, send a letter to QGC shareholders and publish advertisements to the effect that:
 - (i) the QGC Target's Statement contained information deficiencies;
 - (ii) it would withdraw the QGC Target's Statement and issue a replacement target's statement which corrected the information deficiencies; and
 - (iii) it retracted other statements previously made by QGC to ASX that Santos alleged to be misleading; and
 - (b) QGC prepare and despatch to QGC shareholders a replacement target's statement which corrected the identified information deficiencies.

SUBMISSIONS AND REASONING

Basis for QGC's directors recommendation to reject the Offer

19. Santos submitted that QGC clearly emphasised the issue of the value of QGC in the QGC Target's Statement, but that QGC omitted to provide balanced and substantiated information in support of its proposition that QGC shareholders reject the Offer because it was "opportunistic and patently inadequate". In particular, Santos submitted that it was now common practice in Australia for target companies to commission an independent expert's report. It submitted that such reports contained the type of balanced analysis of the target company and its prospects which shareholders would consider material to their decision. Santos noted the decision in *Goodman Fielder Limited* (No.2) [2003] ATP 05.
20. Santos submitted that the QGC directors had made similar comments about the Offer being "opportunistic and patently inadequate" from an early stage of the Offer, even prior to receiving the Santos bidder's statement or the NSAI Report.
21. Santos submitted that by their rejection of the Offer, QGC's directors had warranted that QGC shares were worth more than \$1.26, but had not given QGC shareholders any advice as to what the precise value of QGC shares was and had not given any substantiated reasoning for placing a value of greater than \$1.26 on QGC shares.
22. In response, QGC submitted that the summary of reasons for the directors' recommendation given in the Target's Statement was sufficient to enable QGC shareholders to assess the merits of the Offer without the need for a valuation of QGC shares or a profit forecast for QGC. QGC submitted that if Santos believed that the explanation of QGC's directors' reasons in the QGC Target's Statement was insufficient, it was open to Santos to make that point in a supplementary bidder's statement. QGC submitted that it was not required by law to include an independent expert's report or any other form of valuation.

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23. The Panel issued a brief which sought submissions on the issue of the basis for the QGC directors' recommendation and the adequacy of any supporting evidence and disclosure, and parties provided submissions in response to the Brief. However, as noted above, QGC made an announcement to ASX on 5 December 2006 and issued a supplementary target's statement dated 7 December 2006 (**First Supplementary Target's Statement**) in relation to the AGL Proposal and the Sentient Proposal. The 5 December Announcement and First Supplementary Target's Statement stated that the Proposals were subject to QGC shareholder approval at an extraordinary general meeting (**EGM**) proposed to be held in February 2007. QGC stated in the First Supplementary Target's Statement that it would commission an independent expert to confirm that the AGL Proposal was fair and reasonable for QGC shareholders.
24. QGC stated in the First Supplementary Target's Statement that it expected that QGC shareholders would receive a notice of the EGM, explanatory memorandum and independent expert's report (**EGM Documentation**) in early January 2007. QGC later advised the Panel that it expected the EGM Documentation to be despatched in mid to late January 2007.
25. QGC advised the Panel that it had appointed Deloitte to prepare an independent expert's report⁴ to accompany the EGM Documentation, advising whether, in Deloitte's opinion, the AGL Proposal was fair and reasonable to QGC shareholders. QGC also advised the Panel that Deloitte would assess the value of QGC shares on a stand alone basis for the purpose of its report.
26. On 11 December 2006, Santos extended the offer period under its bid until 31 January 2007.

Discussion

27. The Panel considered that the Application had to be considered in light of the announcement of the Proposals, which were subject to the approval of QGC shareholders at a meeting proposed for February 2007.
28. The Panel considered that QGC's directors would have an obligation to provide proper disclosure about the AGL Proposal and Sentient Proposal and the basis of their recommendations for those Proposals in the EGM Documentation. The Panel also considered that if Deloitte prepared its report in accordance with:
 - (a) policy guidance issued by ASIC (that is, ASIC Policy Statements 74 and 75 and ASIC Practice Notes 42 and 43); and
 - (b) Deloitte's terms of engagement, i.e. that Deloitte would provide an assessment of the value of QGC's shares on a stand alone basis,then QGC's shareholders should have:
 - (a) sufficient information to be able to assess:
 - (i) the value of QGC shares on a stand alone basis; and
 - (ii) the relative merits and demerits of the Offer and the AGL Proposal; and
 - (b) information to assist them to assess the Sentient Proposal.

The Panel also considered that the above factors would assist QGC shareholders to decide whether or not they should accept the Offer.

⁴ The report is for the purposes of item 7 of section 611.

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29. Accordingly, on the basis of the further information to be provided to QGC shareholders in the EGM Documentation, the Panel did not consider that QGC shareholders would be materially assisted by receiving further information in the form of another supplementary target's statement explaining only the basis of QGC's directors' recommendation in relation to the Offer when that was no longer the only investment decision before them. The Panel considered that the Proposals (in particular, the AGL Proposal) and the Santos takeover bid were mutually exclusive transactions and QGC shareholders faced a clear choice between them.
30. The Panel reached this conclusion because:
- (a) further information would be provided in mid-late January 2007 in the forthcoming EGM Documentation (including Deloitte's independent expert's report) in relation to the AGL Proposal and the Sentient Proposal;
 - (b) the closing date for Santos' Offer had been extended to 31 January 2007;
 - (c) the meeting to consider the AGL Proposal was not due to be held until February 2007; and
 - (d) QGC shareholders who chose to trade in the current market knew that they were trading in a period prior to significant information releases in relation to proposals that may change the value of their shares materially.
31. Therefore, the Panel decided that the changed circumstances before it had overtaken the circumstances to which the Application related, such that the Panel considered that it was not necessary to determine whether unacceptable circumstances had arisen in connection with the issues raised in Santos's complaint about the basis of QGC's directors' recommendation and statements in the QGC Target's Statement.
32. The Panel advised both Santos and QGC that if the EGM Documentation and Deloitte expert's report were not adequate or there was a material deficiency of information following the release of that information, it would be open to Santos or any other person to make a further application to the Panel.

Disclosure of the NSAI Report

33. Santos submitted that the QGC directors should have provided the full NSAI Report in the QGC Target's Statement to enable QGC shareholders to understand QGC's reserves position and the analysis, assumptions and limitations underlying NSAI's estimates work and to understand the weight they might give to the reserves which QGC reported in the QGC Target's Statement. Santos also submitted that given the extent to which QGC's value was attributable to its reserves, it was imperative that there was full and balanced disclosure of all material information concerning them.
34. QGC submitted that the NSAI Report was prepared for the purpose of certifying QGC's reserves, rather than to value QGC's shares, and may have tended to mislead QGC shareholders. In particular, QGC submitted that Santos had characterised its Offer as representing "*an attractive reserves valuation multiple of \$1.38/GJ of proved and probable gas reserves compared to an average of \$0.57/GJ for other recent comparable transactions.*" QGC submitted that it was important for the most up to date reserves figure to be provided to QGC shareholders for them to be given an up to date valuation multiple rather than the multiple Santos provided which was based on February 2006 reserves certification (423 PJ February 2006 vs. 695 PJ November 2006).

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35. QGC also submitted that its practice in the past has been not to publish in full NSAI reports when QGC updated its reserves reports to the market. QGC also submitted that Santos, which had previously employed NSAI to provide reserves reports, had previously not published the NSAI reports when reporting its reserves to the market.
36. QGC submitted that the reserves data and the procedure undertaken by NSAI to estimate the reserves, which was included in the NSAI Report, was already included in its Target's Statement.
37. On 1 December 2006, QGC announced to ASX that NSAI had provided economic certification for QGC's reserve upgrade which was the subject of the NSAI Report.
38. On the Panel's request, QGC provided to the Panel a copy of the NSAI Report as well as the further report of NSAI setting out the economic certification for QGC's reserve upgrade, announced on 1 December 2006. The Panel considered both of the reports from NSAI.
39. The Panel considered that in light of the 5 December Announcement and the First Supplementary Target's Statement and as Deloitte would assess the value of QGC shares on a stand alone basis, Deloitte would need to take into account all relevant underlying data about QGC's operations, including its reserves position. The Panel advised parties that it expected that in order to properly conduct the valuation, Deloitte would need to have regard to the NSAI Report and any other similar technical expert reports, and form a view as to the reliability of those reports. The Panel considered that it was a matter for Deloitte to decide the nature and character of the technical expert information which it would address in its independent expert's report and the information that it would disclose in its report⁵. It was not appropriate for the Panel to pre-empt Deloitte's decision in this respect.
40. In these circumstances, the Panel did not consider that QGC shareholders would be materially assisted by QGC releasing the NSAI Report or the subsequent report by NSAI regarding the economic certification for QGC's reserve upgrade before the EGM Documentation was despatched to QGC shareholders.

Other Disclosure Issues

41. Following the initial correspondence between Santos and QGC, QGC offered to provide a supplementary target's statement to address a number of issues raised by Santos. Those issues were not the subject of these proceedings, but were included in the second supplementary target's statement which QGC published in response to these Proceedings.
42. Santos submitted in its Application a long list of other disclosures in the QGC Target's Statement which it submitted were inadequate or misleading (**Disclosure Issues**).
43. The Panel gave a Brief to parties raising the main issues in the Application, other than the Disclosure Issues, and asked parties to discuss the Disclosure Issues with a view to resolving them. The Panel was disappointed that the parties between them essentially failed to settle any of the Disclosure Issues and came back to the Panel for it to settle all of the Disclosure Issues originally in the Application, the majority of

⁵ This is consistent with ASIC's approach to disclosure of specialist reports in ASIC Practice Note 43, see para PN 43.28.

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which, it appeared to the Panel, should have been resolved by the parties with little or no prejudice to either Santos or QGC and definitely none to QGC shareholders.

44. The Panel identified a small number of the Disclosure Issues with which it had concerns and which it advised QGC that it should address in a further supplementary target's statement to improve the information that had been provided to QGC shareholders to assess whether or not to accept the Offer. The Panel also identified to QGC a number of disclosure issues which it considered QGC should not repeat in any future documents provided to QGC shareholders.
45. QGC agreed to provide a further supplementary target's statement to address the issues raised by the Panel (these issues represented some of those contained in the Application). QGC had previously agreed with Santos to make some other additional disclosures. See Annexure A for the Disclosure Issues on which the Panel requested QGC to make further or amending disclosure.
46. The Panel considered that the further supplementary target's statement agreed to be issued by QGC was adequate to address any concerns that the Panel had in relation to those other disclosure issues raised in the Application.

Sentient Proposal

47. In coming to its decision, the Panel considered the information in the first supplementary bidder's statement concerning the AGL Proposal and the Sentient Proposal. Although disclosure about the Sentient Proposal was not formally a part of the Application, the Panel considered that it was relevant to its decision. The Panel considered that QGC should disclose more information about the Sentient Proposal, in particular, a more complete summary of the commercial and financial terms of the Sentient Proposal, the extent to which the Sentient Proposal was interdependent with the AGL Proposal and what part or parts of the Sentient Proposal would be placed before the QGC shareholders for their decision. The Panel considered that this disclosure could be given to QGC shareholders in the EGM Documentation.

DECISION

48. Having regard to the further disclosures agreed to be provided by QGC in a second supplementary target's statement, the recent announcements by QGC about the Proposals, the further information to be provided in the EGM Documentation (including Deloitte's report) and submissions from QGC and Santos, the Panel decided not to make a declaration of unacceptable circumstances in relation to the Application.
49. The Panel did not consider that it was against the public interest to decline to make a declaration of unacceptable circumstances.
50. As the Panel did not make a declaration, it made no order for costs.

Norman O'Bryan SC
President of the Sitting Panel
Decision dated 19 December 2006
Reasons published 30 January 2007

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ANNEXURE A

LIST OF DISCLOSURE ISSUES IDENTIFIED BY THE PANEL

Statement in the QGC Target's Statement	Panel's views
The reference to '80% of its tenement areas which it considers to have CSG potential' (second bullet point, page 6)	The Panel considered that QGC should provide some explanation to assist readers to understand the geographical areas to which it is referring, for example identify the proportion of its tenement areas which <u>have</u> CSG potential before making this statement.
"QGC expects to exceed the 1,000 PJ target for 2P Reserves by August 2007." (fifth bullet point, page 6)	It appeared to the Panel that there is nothing in the target's statement that clearly supports the statement that QGC expected to exceed the 1000PJ target. There did not appear to be a clear basis given in the target's statement for making the statement. The Panel considered that, at a minimum, the statement should cross refer to the Growth Acceleration Strategy in section 3 of the target's statement and the risk section in QGC's second supplementary target's statement.
The reference to 'unsuccessfully explored' in the second bullet point, page 10	It was not clear to the Panel that the reference to "unsuccessfully explored" was to QGC's previous management, as submitted by QGC to the Panel. The Panel considered that, if the statement remained in the target's statement, it should be clarified at least to the extent given by QGC in its submissions to the Panel.
The fifth bullet point on page 10 reference to QGC's average cost of finding gas to be 3 cents per gigajoule.	It appeared to the Panel that the statement that QGC believed this "to be lower than many other industry participants" was not supported by any evidence in the target's statement. The Panel considered that QGC should either delete the statement that QGC believed its cost of finding gas is "lower than many other industry participants" or provide some basis and justification for that belief statement (for example, by giving some examples of their competitors' costs and demonstrating how it derived the 3 cents per gigajoule value).
The chart at the bottom of page 5, read together with the adjacent label "It is too soon in QGC's growth to sell".	The Panel considered that the graph (in particular the diagonal line with the arrowhead) tended to suggest that the 1P and 2P reserves growth will continue in an "upward" motion in future. The Panel considered that QGC should remove the arrow in the diagonal line to remove any suggestion that its reserves growth will continue at the same rate as it previously has, or provide its basis for making such a projection.
The chart on page 7 on QGC's share price history.	The Panel considered that the graph (in particular the diagonal line with the arrowhead) tended to suggest that the share price will continue in an "upward" motion in future. The Panel considered that QGC should remove the arrow in the diagonal line to remove any suggestion that its share price growth will continue at the same rate as it previously has, or provide its basis for making such a projection. The Panel also considered that the graph should also disclose QGC's historical share price information over the relevant period by using a line graph showing the actual movements more realistically.