



Perilya Limited 02
[2009] ATP 1

Catchwords:

Frustrating action – shareholder approval – lock-up device – anti-competitive – coercive – placement – call option – refundable deposit – notice of meeting – independent expert’s report – supplementary target’s statement – unsubstantiated statements of intention – commercial imperative – available remedies – decline to conduct proceedings

Perilya Limited – CBH Resources Limited – Broken Hill Operations Pty Limited – Shenzhen Zhongjin Lingnan Nonfemet Co., Ltd

Corporations Act 2001 (Cth), sections 602, 606, 611 – item 7, 657A, 657D and 657E

Takeovers Panel Guidance Note 7 (lock-up devices), paragraph 42

Takeovers Panel Guidance Note 8 (matter procedure), paragraph 45

Takeovers Panel Guidance Note 12 (frustrating action), paragraph 38

Resource Pacific Holdings Ltd [2007] ATP 26

INTRODUCTION

1. The sitting Panel, John Keeves, Alison Lansley and Jennifer Seabrook (sitting President), declined to conduct proceedings on an application from BHO in relation to the affairs of Perilya.
2. In these reasons, the following definitions apply.

Term	Meaning
BHO	Broken Hill Operations Pty Limited
Call Option Deed	Call Option Deed dated 18 December 2008 between Perilya, Perilya Freehold Mining Limited and Shenzhen
CBH	CBH Resources Limited
Perilya	Perilya Limited
Shenzhen	Shenzhen Zhongjin Lingnan Nonfemet Co., Ltd
Subscription Agreement	Subscription Agreement dated 5 December 2008 between Perilya and Shenzhen pursuant to which Shenzhen is to subscribe for 197,672,000 Perilya shares at \$0.23 per share to raise \$45,464,560

FACTS

3. Perilya is a public company listed on ASX (ASX code: PEM). CBH is a public company listed on ASX (ASX code: CBH). Perilya is the subject of an off-market scrip takeover bid by BHO, a wholly owned subsidiary of CBH.

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4. On 25 November 2008, the Perilya board met to receive an update on a number of alternative proposals including the proposal involving Shenzhen.
5. On 5 December 2008, the Subscription Agreement was executed. The Subscription Agreement contemplates the payment of a refundable deposit and the grant of a call option over Perilya's Mt Oxide exploration asset.
6. On 9 December 2008, Perilya announced that it had agreed a placement of shares to, and strategic partnership with, Shenzhen (described as being China's third largest zinc producer). The placement is subject to, among other things, the approval of Perilya shareholders in general meeting (the EGM).
7. On 18 December 2008, the Call Option Deed was executed.
8. On 29 December 2008, Perilya announced that it had received a \$10 million refundable deposit from Shenzhen on 24 December 2008 in connection with the placement and had granted Shenzhen the call option referred to above, which allows Shenzhen to require Perilya to sell to Shenzhen a major asset of Perilya (the Mt Oxide asset) for \$15m¹ if the placement does not proceed and the deposit is not repaid. The deposit would be repayable 20 days after the earlier of the date on which a condition precedent to the placement fails and 31 March 2009. Shenzhen would be able to call for the Mt Oxide asset for a period of 30 days from the date on which the deposit is repayable (unless the deposit is repaid before the call option is exercised). On the basis of the meeting date of 5 February this would be between 21 April and 20 May 2009.
9. On 5 January 2009, Perilya dispatched its notice of meeting for the EGM², which included an independent expert's report. The EGM is scheduled to be held on 5 February 2009. The notice of meeting included the following statements in relation to Perilya's financial position.

*"In particular, if the Zhongjin Lingnan Transaction is not implemented – and in the absence of alternatives, Perilya will need to raise comparable funding by 31 March 2009 to ensure that it continues to operate as a going concern. In the current equity capital markets environment any raisings would likely be at a significant discount to the current market price of Perilya shares and well below the proposed issue price of New Shares to Zhongjin Lingnan and a significant dilution to existing Shareholders. Further, in the absence of alternative capital raisings, Perilya may need to sell one or more of its assets (other than in the ordinary course of business and at distressed values or values different to those in its financial statements)."*³
10. The call option, by its terms, is not subject to the approval of Perilya shareholders. However, Perilya shareholders will be asked in resolution 1 at

¹ An unrelated third party had offered to buy this asset at the same price

² References to the notice of meeting are to the notice of EGM and accompanying explanatory memorandum

³ Section 1.3 of the notice of meeting

the EGM to consider and, if thought fit, approve the terms of both the placement and the call option.

APPLICATION

Declaration sought

11. By application dated 12 January 2009, BHO sought a declaration of unacceptable circumstances in relation to the placement and the call option. BHO submitted that:
 - (a) Perilya's agreement to the placement was a frustrating action (notwithstanding that the placement is subject to shareholder approval) as shareholder approval would be given when there is a deficiency of information. BHO submitted that the audit reviewed financial statements of CBH and Perilya for the 6 months to 31 December 2008 would contain important information for Perilya shareholders to decide between the merits of its bid and the proposal involving Shenzhen.
 - (b) Perilya's entry into the call option without it being subject to shareholder approval was a frustrating action.
 - (c) The placement, combined with the call option, was an anti-competitive and coercive lock-up device.
 - (d) Statements in the notice of meeting regarding Shenzhen's long term partnership with, and commitment to the development of, Perilya were unsubstantiated and unqualified, given that Shenzhen is not subject to any binding obligation requiring it to behave according to those statements.
 - (e) The notice of meeting does not set out how long the funds to be received by Perilya from the placement are expected to last, what Perilya plans to do once those funds are exhausted and the risks associated with that plan.
12. BHO submitted that the circumstances had the following effects.
 - (a) The acquisition of control of Perilya was not taking place in an efficient, competitive and informed market.
 - (b) Perilya shareholders will not be given a reasonable and equal opportunity to participate in the benefits available under BHO's bid, as an alternative to the proposal involving Shenzhen.
 - (c) Perilya shareholders have not been given enough information to assess the merits of either BHO's bid or the proposal involving Shenzhen.
 - (d) Perilya shareholders are likely to be misled into believing the Shenzhen proposal is more attractive than it is and BHO's offer is less attractive than it is.

Orders sought

13. BHO sought interim orders that, if the final orders sought were not made by 5 February 2009, the EGM be deferred and Shenzhen be restrained from exercising the call option. We did not need to decide whether to make an interim order.
14. BHO sought final orders that:
 - (a) the EGM be deferred until 24 March 2009
 - (b) the Call Option Deed be terminated and
 - (c) Perilya prepare and dispatch a supplementary target's statement (see paragraphs 11(d) and (e)).

DECISION

15. In deciding whether to conduct proceedings in relation to an application, the Panel considers the factors set out in paragraph 45 of Guidance Note 8, which include "whether the accusations would give rise to unacceptable circumstances if proven" and "what remedies might be available to the Panel to address the alleged unacceptable circumstances".
16. We decline to conduct proceedings in relation to each of the matters raised in the application as we are not satisfied that there is a reasonable prospect of a declaration of unacceptable circumstances or the making of orders in this case.

Placement

17. BHO submitted that the placement triggered conditions to its offers and that those triggering actions had a material effect on the objective of its bid. The placement is subject to shareholder approval. However, it submitted that shareholder approval would be insufficient as it would be given when there was a deficiency of information. The deficiency was:
 - (a) the audit reviewed financial statements of CBH and Perilya for the 6 months to 31 December 2008 and
 - (b) use of the placement funds.
18. Perilya included an independent expert's report in its notice of meeting.⁴ The report includes unaudited financial information on Perilya up to 31 October 2008⁵ and a high-level comparison between the BHO bid and the proposal involving Shenzhen.⁶ In our view shareholders have enough information so that we are not prepared to delay the shareholders' meeting for additional

⁴ Dated 24 December 2008, after the decision in *Perilya Limited 01* on 19 December 2008

⁵ Section 3.3 of the independent expert's report

⁶ Section 7.4 of the independent expert's report (which section was updated, following this decision, on 19 January 2009 by a supplementary independent expert's report)

information about the BHO bid to be made available even if, by then, that information could incorporate half yearly accounts for Perilya.

19. BHO has the capacity to put additional information relevant to its bid before shareholders if it wishes, even accepting that CBH's and Perilya's audit reviewed financial statements for the half year ended 31 December 2008 may not yet be prepared or available.
20. Perilya cannot be expected not to proceed with a transaction because information is not yet available or has not been released by the party seeking to prevent that transaction from occurring. Nor must it wait for a 'window' after releasing half yearly (or other periodic) accounts.
21. As for use of the placement funds, shareholders are reasonably able to make a decision based on the existing information, which includes the financial position of Perilya, the fact that Shenzhen is to become a 51% shareholder, the independent expert's report and statements as in section 2.3.1 of the notice of meeting that *"The ideal position was to find a source of new equity funding that injected cash into the Company sufficient to enable Perilya weather a sustained period of economic downturn."*⁷

Deposit and call option

22. A deposit in relation to a placement of shares is unusual. The deposit in this case was also significant: \$10 million out of \$45 million to be raised under the placement. There is a risk that a company agreeing to a refundable deposit, when combined with a call option over an asset, could act as a financial penalty and so coerce shareholders, or amount to a sale of an asset that is a frustrating action.
23. Perilya submitted that it was commercially imperative that it receive the deposit in advance of the EGM. Shenzhen indicated that it required the call option to support Perilya's obligation to repay the deposit. The deposit was conditional on the call option.
24. In support of its submission, Perilya provided a cash flow forecast (for the period from 31 October 2008 to 28 February 2009) which was tabled at the Perilya board meeting on 25 November 2008. Perilya submitted that its board considered a number of alternative transactions to raise an amount equivalent to the deposit amount. These included:
 - (a) the sale of the Mt Oxide asset to an unrelated party
 - (b) the sale of its commercial paper and other investments
 - (c) providing alternative security and
 - (d) taking on debt financing.

⁷ See also Chairman's letter on page 6 of the notice of meeting

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25. The deposit and call option approach was preferred by the Perilya board. Certainly, it would allow Perilya's cash position to be supported ahead of the shareholder approval and potentially allow Perilya to retain the Mt Oxide asset if the placement was approved or the deposit repaid.
26. On 15 December 2008, Perilya released its target's statement which disclosed that Perilya was "*in a strong financial position*". We note the different emphasis that Perilya gave in relation to its financial position in its target's statement and its notice of meeting dated 5 January 2009. We have assumed that Perilya's financial position is as stated in its notice of meeting. The submissions above are also consistent with its financial position as stated in its notice of meeting.
27. The situation that companies face in credit and share markets at the moment is unusual. Considerable volatility in these markets, and in commodity prices and exchange rates, adds risk to every transaction. It is not our role to second guess the commercial decisions of the board. Indeed, we are concerned with the effect of a particular set of circumstances not the intention behind them. Nevertheless, if it appears from credible material that the board is making decisions to ensure that the company has enough cash to continue as a going concern, and they are seeking to meet their obligations regarding insolvent trading in the period up to and including a shareholders' meeting, we should give considerable weight to this fact. This is particularly so in these unusual times where market volatility could have a significant impact on the financial standing of the company.
28. There may be situations in which the Panel does need to consider whether a commercial decision by a board gives rise to unacceptable circumstances. In doing so the Panel must consider whether any decision it makes will overcome the unacceptable circumstances without causing unfair prejudice to any party.
29. The Panel must balance the impact of its decision on the company and other interested parties, including whether its decision may place the company in a precarious financial position given its circumstances and those in the markets at that time. This is the situation that we face in this case. We are not satisfied that a declaration, or the orders sought by BHO, would be appropriate. Perilya's situation is such that the same outcome may not be applicable in other situations.
30. Paragraph 32 of Guidance Note 12 refers to actions of a target which may be frustrating actions but which are commercially imperative. In circumstances where the board has made a decision which appears reasonable to avoid what is potentially a materially adverse financial effect on the company, that decision would meet the requirements of Guidance Note 12 so as not to make the

frustrating action an unacceptable circumstance.⁸ This is particularly the case where the decision is made to support the ordinary course of business or is one involving an asset which is not the “crown jewels” of the company⁹. Of course such a decision should not be taken lightly - it must appear genuinely to be an imperative, not simply desirable.

31. We are not satisfied that the deposit and call option aspects of the transaction have been designed to frustrate the bid. We are satisfied that there was a commercial imperative for Perilya to receive the deposit in advance of the EGM. As the deposit may be repaid we are not satisfied that any potential coercive effect on Perilya shareholders would be material.
32. We are also not satisfied that the deposit and the call option amount to an unacceptable asset lock-up in this case. The Mt Oxide asset is not the “crown jewels” of Perilya, although it appears to be a major asset. If sold, it will be at a price that an unrelated party was earlier willing to pay. If the proposal involving Shenzhen does proceed, the asset will not be sold.
33. The independent expert assessed the value of the Mt Oxide asset for the purpose of its report. It looked at the sales activity around the asset and the proposed terms of the call option. It assessed the value of the asset as \$15m.¹⁰ Thus, in our view, exchanging that asset for \$15m cash should not unreasonably inhibit competition for the control of Perilya.

Statements in notice of meeting

34. BHO submitted that Perilya’s notice of meeting included numerous statements regarding Shenzhen’s current and future involvement in Perilya which are unsubstantiated and unqualified and, as such, are likely to mislead Perilya shareholders. BHO referred to the following statements on page 1 of the notice of meeting by way of example.

“Zhongjin Lingnan is a ... long term strategic partner”

“Zhongjin Lingnan is supportive of Perilya’s management and current operating plan”

“Zhongjin Lingnan is committed to the long-term development of Perilya’s assets and to the future growth of Perilya”

35. BHO referred to a summary of the Subscription Agreement set out in annexure A to the notice of meeting. BHO submitted that, other than an obligation to subscribe for Perilya shares and enter into good faith negotiations in relation to future off-take arrangements, Shenzhen was under no binding obligation to act consistently with the above statements.

⁸ See also *Resource Pacific Holdings Ltd* [2007] ATP 26. That Panel declined to conduct proceedings on a rights issue that was subject to shareholder approval but was nevertheless a triggering action because, among other things, the company had an immediate need for funds

⁹ Guidance Note 7, paragraph 42

¹⁰ Section 6.2.2 of the independent expert’s report

36. If the placement proceeds, Shenzhen will hold a 50.1% stake in Perilya. Given the extent of this investment, it was not unreasonable in our view for Perilya to make the above statements. We were not convinced in this case that those statements needed to be based on, or supported by, binding obligations on Shenzhen.

Available remedies

37. The likelihood of a suitable remedy is one of the factors that we took into account when deciding whether to conduct proceedings on this application.
38. Given Perilya's financial position and its overall need for funds by 31 March 2009 we consider that, if the date of the EGM were deferred as requested by BHO (or earlier in March 2009) and the proposal involving Shenzhen were not approved, Perilya may find itself with insufficient time to arrange and implement an alternative transaction.
39. The orders sought by BHO:
- (a) in respect of deferral of the meeting, risk unduly prejudicing Perilya and its shareholders
 - (b) in respect of terminating the Call Option Deed, risk unduly prejudicing Shenzhen or, if the deposit became immediately repayable, Perilya and its shareholders and
 - (c) in respect of the supplementary target's statement, were not appropriate given our conclusion in paragraph 36.

No reasonable prospect of a declaration

40. Accordingly, we decided not to conduct proceedings in relation to the application under regulation 20 of the ASIC Regulations.

Orders

41. As we have not made a declaration of unacceptable circumstances, we make no orders.

Jennifer Seabrook
President of the Sitting Panel
Decision dated 20 January 2009
Reasons published 21 January 2009