



In the matter of Financial Resources Limited

[2007] ATP 27

Catchwords:

administrator; decline to commence proceedings; deed of company arrangement; dilution of existing shareholders; disclosure in notice of meeting; effect on control; explanatory statement, factual errors; inconsistencies; independent expert's report; restructure; recapitalisation; supplementary disclosure; timing of application (lateness); time for shareholders to assimilate information; voluntary administration

BDO Consultants (WA) Pty Ltd; Financial Resources Limited; Panga Pty Ltd; Questus Capital Group Pty Ltd; Questus Funds Management Ltd; Solon Capital Pty Ltd

These are the Panel's reasons for declining to commence proceedings in response to an application by Panga Pty Ltd in relation to the affairs of Financial Resources Limited and a proposed shareholder meeting to consider a restructure and recapitalisation proposal that would, if approved, result in Questus Capital Group Pty Ltd increasing its voting power in Financial Resources to 48.8% .

THE PROCEEDINGS

1. These reasons relate to an application (Application) to the Panel from Panga Pty Ltd (Panga) on Friday, 2 November 2007, in relation to the affairs of Financial Resources Limited (Financial Resources).

SUMMARY

2. At the time of the Application, Financial Resources was under administration. A shareholders meeting had been convened for Wednesday, 7 November 2007, for the purpose of seeking approval to a restructure and recapitalisation proposal that, amongst other things would, if approved, result in Questus Capital Group Pty Ltd (Questus) increasing its voting power in Financial Resources to 48.8% (Questus Proposal).
3. Panga submitted that the notice of meeting and explanatory memorandum for the scheduled meeting were deficient in that, amongst other things, they did not give shareholders of Financial Resources sufficient information to be able to assess the merits of the Questus Proposal.
4. The Panel considered that it was not likely that unacceptable circumstances would arise.
5. On that basis, the Panel declined to commence proceedings.

THE PANEL & PROCESS

6. The President of the Panel appointed Catherine Brenner, Geoff Brunsdon and Kathleen Farrell as the sitting Panel (Panel) for the proceedings (Proceedings) arising from the Application.
7. The Panel adopted the Panel's published procedural rules for the purposes of the Proceedings.

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8. The Panel consented to the parties being legally represented by their commercial lawyers in the Proceedings.
9. The Panel's reasons for its decision are set out below.

APPLICATION

Background

Financial Resources

10. Financial Resources is a public company admitted to the Official List of ASX.
11. Since 11 May 2007 Financial Resources' securities had been suspended from trading on ASX, and were still suspended at the date of the Panel's decision.

Circumstances leading to proposed meeting

12. On 19 June 2007 Financial Resources entered into an implementation deed (Implementation Deed) with HSBC and Questus.
13. The Implementation Deed provided for a restructure and recapitalisation of Financial Resources i.e. the Questus Proposal, involving, amongst other things, "a 1 for 2 consolidation of share capital, the purchase by Financial Resources of Questus Funds Management Ltd and Solon Capital Pty Ltd for \$3 million to be satisfied by the issue of 150 million shares in Financial Resources together with 50 million 31 December 2012, 5 cent options, Questus undertaking a capital raising of \$3 million and a deed of company arrangement being put in place to govern the manner in which creditors would be dealt with¹".
14. On 20 June 2007 Financial Resources was placed into voluntary administration by its then directors.
15. At a meeting of creditors of Financial Resources on 17 July 2007 the creditors voted to approve of a deed of company arrangement broadly encompassing the terms of the Implementation Deed referred to above.
16. Panga had put forward an alternative proposal to the Questus Proposal, which was considered and rejected by creditors at the meeting on 17 July 2007.
17. A deed of company arrangement (DOCA) in connection with the Questus Proposal was executed on 7 August 2007.
18. On 27 July 2007 Panga put forward to the deed administrators a further alternative proposal for the reconstruction of Financial Resources conditional, amongst other things, on Financial Resources shareholders, at the relevant meeting, rejecting the Questus Proposal.
19. Some time after the execution of the DOCA it was varied such that:
 - (a) "the share capital of Financial Resources would be consolidated on a 1 for 20 basis;
 - (b) Questus would sell the shares in Solon Capital Pty Ltd and Questus Funds Management Ltd in exchange for an issue of 15 million shares and 5 million 31 December 2012, 50 cent options in Financial Resources;

¹ Application, at paragraph 4.1.

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- (c) a capital raising of \$3.5 million would occur by an issue of 17.5 million shares at a price of 20 cents each²” (Capital Raising).
- 20. Questus communicated a number of times with shareholders of Financial Resources regarding the proposed reconstruction of Financial Resources.
- 21. The deed administrator convened a meeting (Meeting) of shareholders of Financial Resources for 7 November 2007, by a notice of meeting dated 4 October 2007.

Independent Expert’s Report

- 22. The notice of meeting was accompanied by an explanatory statement (Explanatory Statement) and an independent expert’s report (BDO Report) prepared by BDO Consultants (WA) Pty Ltd (BDO), together with a letter (Questus Letter) from Questus.
- 23. Panga’s application related to the content of the Explanatory Statement and the BDO Report.

Declaration and orders sought in the Application

- 24. Panga sought interim orders under section 657E(1) to adjourn the Meeting until a reasonable period after the final orders.
- 25. Panga sought a declaration under section 657A(2) that the following circumstances were unacceptable circumstances in relation to the affairs of Financial Resources:
 - (a) failure to disclose relevant information in the Explanatory Statement;
 - (b) errors of fact and law in the Explanatory Statement;
 - (c) failure to disclose relevant information in the Independent Expert’s Report;
 - (d) errors of fact and law in the Independent Expert’s Report;
 - (e) the inclusion together with the Notice, the Explanatory Statement and the Independent Expert’s Report of the Questus Letter , which contained information not included or considered within the Notice, the Explanatory Statement or the Independent Expert’s Report, together with a recommendation by Questus; and
 - (f) failure by the Deed Administrators and the Directors of Financial Resources to carry out any verification of certain material contained in the Explanatory Statement that was provided by Questus.
- 26. Panga sought final orders under section 657D(2) requiring:
 - (a) Financial Resources to prepare a revised or supplementary Explanatory Statement to satisfy Panga’s concerns with the matters referred to in paragraphs 25 (a) to (f) above and to forward it to shareholders of Financial Resources; and

² Application, at paragraph 4.1.

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- (b) BDO to prepare a revised or supplementary Independent Expert's Report to satisfy Panga's concerns with the matters referred to in paragraphs 25 (a) to (f) above and to compel Financial Resources to forward it to shareholders of Financial Resources.

DISCUSSION

Panga's issues of concern

Dilution

- 27. BDO concluded in the BDO Report that the Proposals (contained in the Notice) ***"are fair and reasonable to shareholders"***. In reaching that conclusion BDO stated that it considered a number of advantages and disadvantages, including, amongst other things, the issue of "Dilution of Interest" which the Questus Proposal would cause to the existing shareholders of Financial Resources.
- 28. BDO stated that existing shareholders would retain an interest of ***"between 9.5% and 58.2%"*** depending on whether they did or did not participate in the Capital Raising i.e. it appeared to assume that Financial Resources shareholders could take up all of 17.5 million shares to be issued under a prospectus as part of the capital raising.
- 29. However, in the Explanatory Statement the Deed Administrator stated that ***"If Shareholders are permitted to participate in the Capital Raising then the amount of interest held by Shareholders will range between 9.5% and 58.2%"*** emphasis added.
- 30. The Explanatory Statement also stated, in Section 3.3 of Part B (page 27), that the 17.5 million shares to be issued as part of the Capital Raising were to be issued ***"via a Prospectus, with the allocation of those Shares to be at the discretion of Questus however it is proposed by Questus that existing shareholders will be entitled to subscribe for a total of 2,500,000 Shares pursuant to an offer under that Prospectus, in an amount of up to a maximum of \$5,000 per Shareholder. If applications are received from Shareholders in excess of the amount of \$500,000 all applications will be scaled back on a pro rata basis based on the amount subscribed by the individual Shareholder"***.
- 31. As a result it appeared that if Shareholders were to participate in the Capital Raising then the maximum interest they could hold would be 5,912,500 shares or 16.5% rather than the 58.2% that BDO referred to in its Report.

Control

- 32. When discussing advantages and disadvantages of the Questus Proposal in the BDO Report, BDO also referred to the potential loss of control of Financial Resources by its existing shareholders. BDO referred to the possibility of Questus participating in the Capital Raising and the possibility that it could thereby hold an interest of up to 90.5% of Financial Resources.
- 33. However, the Notice of Meeting and the Explanatory Statement included a resolution that sought approval for Questus increasing its voting power in the Company to 48.8% as a result of the issue of 15 million shares and the exercise of 5 million options.
- 34. Panga submitted that it appeared that the only way that Questus could acquire 90.5% of Financial Resources was if it acquired all of the 17.5 million shares

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under that capital raising, and suggested that it could only do so if permitted as underwriter or sub-underwriter under item 13 of section 611, and if that were the case Questus should have been disclosed as underwriter or sub-underwriter of the capital raising.

35. Panga submitted that the issues of dilution and control were of critical importance to Panga and to shareholders of Financial Resources generally, particularly given that there had been an alternative proposal put forward under which Panga submitted shareholders had been offered the opportunity to suffer no dilution.
36. Panga submitted that:
- (a) the difference between the “9.5% to 58.2%” and the “9.5% to 16.5%” ranges;
 - (b) the reference to Questus possibly holding an interest in Financial Resources of up to 90.5%; and
 - (c) other disclosure issues,
- were likely to mislead Financial Resources shareholders.

Other

37. Panga raised its concerns about other statements in the BDO Report, the Notice of Meeting and the Explanatory Statement including statements concerning the Questus Proposal adding certainty and speed to resolution of Financial Resources’ position.
38. Panga also submitted that approval of the Questus Proposal was required under the Related Party Transaction provisions of the Corporations Act.

Supplementary Disclosure

39. On 2 November, 2007, following communications from Panga, BDO wrote to Financial Resources’ administrator setting out some inconsistencies and factual errors in the BDO Report and the Notice. BDO, however, advised the administrator that in BDO’s opinion, the inconsistencies and factual errors did not alter BDO’s opinion that the Questus Proposal was fair and reasonable to Financial Resources shareholders.
40. The disclosures in the 2 November letter included statements concerning:
- (a) adding “Potential for further dilution of interest” into the “Disadvantages” section of a table comparing the advantages and disadvantages of the Questus Proposal;
 - (b) rewriting the sections 16.2.1 to 16.2.3 of the BDO Report to address the concerns described in the paragraphs above relating to ***Dilution*** and ***Control***;
 - (c) adding a discussion of the effects on ***Dilution*** and ***Control*** of Questus exercising options which were proposed to be issued to Questus under the Questus Proposal.
41. The changes and additions to the revised sections of BDO’s Report were not highlighted (although BDO did bring specifically to shareholders’ attention the

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error it had made in describing the maximum percentage holding of existing shareholders). Financial Resources shareholders were required to read through and compare the text of the two documents to become aware of the changes.

42. On 2 November, 2007, also following communications from Panga, the administrator wrote to Financial Resources shareholders enclosing the letter from BDO and the update to the BDO Report. The administrator also provided a number of clarifications to Financial Resources shareholders in relation to the Explanatory Statement. The Administrator's advice included statements:
- (a) noting that BDO's supplementary document did not change BDO's opinion;
 - (b) Financial Resources' viability rested on the continuing support of Financial Resources' secured creditor, HSBC, which had previously advised it would not support the proposal previously proposed to creditors by Panga;
 - (c) the likely alternative to the Questus Proposal was liquidation of Financial Resources;
 - (d) noting that the table comparing the advantages and disadvantages of the Questus Proposal which had been copied from the BDO Report had changed;
 - (e) confirming that Questus would not subscribe for shares under the Capital Raising, so would stay at a maximum voting power of 48%, and that Questus had received commitments from "independent third parties and a broking house" to take up all of the Capital Raising; and
 - (f) discussing issues of conflict of interest that Panga had raised (because Questus and Financial Resources operated in the same business area and there would be common directors of Financial Resources and Questus).

Questus submissions

43. Questus made submissions to the Panel that the Panel ought not commence proceedings in relation to the Application. Questus submitted that:
- (a) Panga had unreasonably delayed in making the Application;
 - (b) Financial Resources suffered a material risk of unfair prejudice if the meeting was delayed as:
 - (i) Financial Resources was operating on the basis of funding from Questus and support from Financial Resources' secured creditor (HSBC);
 - (ii) the Deed of Company Arrangement would terminate if the Questus Proposal had not been completed by 30 November 2007 (which also required the issue of a prospectus and receipt of funds under the Capital Raising after the meeting had approved the Questus Proposal); and
 - (iii) the administrator considered the likely alternative to the Questus Proposal was liquidation of Financial Resources; and

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- (c) the issues of inconsistency and factual error raised by Panga were inconsequential and the significant issues were addressed by the 2 November communications to Financial Resources shareholders.

Panel consideration

- 44. The Panel considered that while Panga raised concern about the level of disclosure on a wide range of issues, and that the understanding of Financial Resources shareholders may well have been improved if all of Panga's comments had been addressed:
 - (a) the most significant disclosure errors and inconsistencies which Panga complained of could, with reasonable diligence, be discovered in the information disclosed to Financial Resources shareholders;
 - (b) although there were errors and inconsistencies in the information concerning disclosure in relation to Financial Resources shareholders' dilution under the Questus Proposal, which Panga raised, the correct factual matrix could reasonably be determined from the information disclosed to Financial Resources shareholders;
 - (c) the supplementary information provided to Financial Resources shareholders by the administrator on 2 November adequately noted and corrected the most significant errors in the original explanatory statement and expert's report (although *shareholders were unlikely to have received the 2 November letter until after the time for lodgement of proxies had closed*);
 - (d) BDO advised Financial Resources shareholders that the factual errors and inconsistencies did not change its view as to the fairness of the Questus Proposal; and
 - (e) Financial Resources shareholders would have a reasonable time within which to consider the supplementary information.
- 45. The Panel was also concerned to ensure that the Application, and any decision that the Panel made, did not unreasonably interfere with the role of the administrator in bringing the affairs of Financial Resources back to solvent operations as readily as possible.
- 46. The Panel was concerned at the relatively short time that Panga had left for the Panel to consider the Application prior to the Meeting. The Application was made on Friday 2 November, 2007. The meeting documents had been sent to Financial Resources shareholders on 5 October, 2007. The meeting was due to be held at 10.30 a.m. WDT on Wednesday 7 November. In the event, however, the Panel considered that the issues raised by Panga were not likely to give rise to unacceptable circumstances, so it did not have to take the lateness of the Application into its considerations. While the Panel was prepared to take any appropriate action, Panga's delay in bringing the Application caused the potential for a material conflict between the interests of ensuring that Financial Resources shareholders received adequate information, and the risk of causing harm to the prospects of returning Financial Resources from administration which delaying the meeting ran.

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47. The Panel was similarly concerned at the short time which Panga had given the administrator to consider and address the disclosure issues with which Panga had concerns.

DECISION

48. On the basis that it considered that unacceptable circumstances were unlikely to have occurred, the Panel declined to commence proceedings in response to the Application.

Kathleen Farrell

President of the Sitting Panel

Decision dated: 7 November 2007

Reasons published: 21 December 2007