JOHNSON WINTER & SLATTERY

LAWYERS

Memorandum

Date: 27 September 2010

To: Greg Meredith, Envestra Limited

From: John Keeves

Subject: **Standards for Independent Expert's Reports**

Our Ref: A3170

You have asked us to summarise the standards with which expert reports, relating to company valuations, are required to comply under the Corporations Act 2001 (Cth) (**Corporations Act**), Australian Securities and Investments Commission Act 2001 (Cth) (**ASIC Act**), the ASX Listing Rules, ASIC guidelines and the common law.

There are a number of corporate transactions where an expert report may be required under applicable law and listing rules, including takeover bids, schemes of arrangement, compulsory acquisitions or buy-outs and related party transactions[1]. Regardless of the transaction, an expert report must be prepared with reasonable care and skill, otherwise the expert may incur liability to the company (to whom the report relates) and its shareholders in negligence. If an expert report contains errors or inaccuracies or is otherwise misleading then it may also result in a successful misleading and deceptive conduct claim against the expert.

An expert report prepared in the context of a takeover must comply with the Corporations Act and ASIC guidance in the form of ASIC Regulatory Guide 111, otherwise it may be for example, subject to challenge before the Takeovers Panel or provide a basis for an expert's financial services licence to be challenged.

1 Corporations Act and ASIC Act

Except in relation to compulsory acquisitions and compulsory buy-outs,[2] the Corporations Act and ASIC Act do not prescribe the valuation methodologies that an expert should use in preparing its report[3]. The principles that ASIC views as appropriate in determining value are set out in section 3 of this memorandum.

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[1] Whether or not an expert report is required by law or listing rules it is common practice for expert reports to be commissioned in takeover bids and schemes of arrangement.

[2] Section 667 of the Corporations Act requires the fair value for securities to be determined for the purpose of a compulsory acquisition or compulsory buy-out as follows:

(a) first, assess the value of the company as a whole;

(b) then allocate that value among the classes of issued securities in the company (taking into account the relative financial risk, and voting and distribution rights, of the classes); and

(c) then allocate the value of each class pro rata among the securities in that class (without allowing a premium or applying a discount for particular securities in that class).

Further, without limiting the above, the consideration (if any) paid for securities in that class within the previous 6 months must be taken into account.

[3] The Corporations Act provides, where an expert's report is required in relation to a takeover (see section 640), the report must state whether the offers are fair and reasonable. Schedule 8 of the

Although the Corporations Act does not generally prescribe valuation methodologies, it does prescribe general standards with which an expert must comply. An expert would be guilty of an offence if it makes, or authorises the making of, a statement in a document required by the Corporations Act to be lodged or submitted to ASIC (including an expert's report) that to the expert's knowledge is false or misleading in a material particular or omits or authorises the omission of any matter or thing without which the document is to the expert's knowledge misleading in a material respect.[4] It is also an offence if an expert fails to take reasonable steps to ensure that the statement was not false or misleading.[5]

In addition, an expert's report typically constitutes the giving of financial product advice so an expert must usually hold an Australian financial services (**AFS**) licence. As such, the Corporations Act imposes additional obligations on an AFS licensee which include:

(a) doing all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly;[6]

(b) maintaining the competence to provide the financial services, including having sufficient human and technological resources to provide the services specified in its license and ensuring its staff are adequately trained and competent to provide those services;[7]

(c) complying with the financial services laws (which includes Division 2 of Part 2 of the ASIC Act[8]);

(d) not, in the course of carrying on a financial services business, engaging in dishonest conduct in relation to a financial product or financial service;[9] and

(e) not engaging in conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive.[10]

An expert would therefore need to comply with the above requirements in undertaking a valuation for the purposes of its independent expert's report, where such report is required by the Corporations Act. Otherwise, it could become liable for various penalties, claims and enforcement action including under the Corporations Act and/or the ASIC Act.

2 ASX Listing Rules

The ASX Listing Rules specify certain circumstances where an expert's report is required for ASX listed companies (for example, transactions with persons in a position of influence[11]), however the ASX Listing Rules do not prescribe the valuation methodologies that an expert should use in preparing its report other than requiring the expert to state whether the transaction is fair and reasonable. Nor do the ASX Listing Rules expressly impose any separate obligations on an expert.

Corporations Regulations provides, where an expert's report is required in relation to a scheme of arrangement (see item 8303), the report must state whether the scheme is in the best interests of the members of the company.

[4] Section 1308(2) of the Corporations Act.

[5] Sections 1308(4) and 1308(5) of the Corporations Act.

[6] Section 912A(1)(a) of the Corporations Act.

[7] Section 912A(1)(e) of the Corporations Act and ASIC Regulatory Guide 111, para RG 111.101.

[8] Division 2 of Part 2 of the ASIC Act prohibits a person from, in trade or commerce, engaging in conduct in relation to financial services that is misleading or deceptive or likely to mislead or deceive.

[9] Section 1041G of the Corporations Act.

[10] Section 1041H of the Corporations Act.

[11] ASX Listing Rule 10.10.2.

3 ASIC Guidelines

ASIC provides its views on the different valuation methodologies and the treatment of assumptions used by experts in Regulatory Guide 111.

ASIC Regulatory Guides do not have the force of law but give guidance by:

(a) explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act);

(b) explaining how ASIC interprets the law;

(c) describing the principles underlying ASIC's approach; and

(d) giving practical guidance.

Contravention of such guidelines would not, of itself, give ASIC or any other person the right to take action against an expert, but the contravention may be evidence of non-compliance with the standard of reasonable care with which an expert is required by the common law to comply, which may in turn assist in making out a claim for misleading and deceptive conduct or, for reports prepared in the context of a takeover, lead to a declaration by the Takeovers Panel of unacceptable circumstances. Further, as one of the functions of such guidelines is to explain how ASIC interprets the law, contravention of the guidelines gives an indication of where ASIC is likely to exercise its powers of investigation and inspection,[12] with a view to taking enforcement action (if it can establish that a provision of the Corporations Act and/or ASIC Act has been contravened). The types of action that may be taken by ASIC if it has an objection to an expert's report include any one or more of the following:

(a) in a takeover bid, making an application to the Takeovers Panel for a declaration of unacceptable circumstances;

(b) in a scheme of arrangement, opposing the scheme at a court hearing;

(c) causing a prosecution of the expert to be begun or carried on in respect of any offence committed by the expert;[13]

(d) causing civil proceedings to be begun and carried on in the name of a person affected by the expert's conduct[14] or taking action in its own name for a contravention of misleading or deceptive conduct or other applicable provisions;

(e) revoking or suspending the expert's AFS licence or adding a condition after a hearing;[15]

(f) making a banning order that prohibits the expert from providing any financial services or specified financial services in specified circumstances or capacities;[16] or

(g) ceasing or suspending nominating the expert to prepare reports in compulsory acquisitions for the purposes of section 667AA of the Corporations Act.

A summary of ASIC's key views in respect of valuation methodologies, as set out in Regulatory Guide 111, is outlined below.

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[12] Divisions 1 to 4 of Part 3 of the ASIC Act.

[13] Section 49 of the ASIC Act.

[14] Section 50 of the ASIC Act.

[15] Sections 915B, 915C and 915E of the Corporations Act.

[16] Section 920A of the Corporations Act.

An expert is required to use its skill and judgment to select the most appropriate methodology or methodologies in its report and must have a reasonable (or tenable) basis for choosing its valuation methodologies. [17] An expert needs to ensure that the choice of methodology or methodologies is appropriate for the circumstances of the transaction. An inappropriate choice might be misleading and might also lead to liability because the expert did not take sufficient care and skill in the preparation of the report.[18]

ASIC considers that an expert should, when possible, use more than one valuation methodology to reduce the risk that the expert's opinion is distorted by its choice of methodology.[19] Usually, an expert should also give a range of values given that the value of securities is typically subject to uncertainty and volatility, however the range of values should be as narrow as possible.[20]

In general, ASIC expects an expert preparing an expert's report to be an expert in the relevant field. An expert is defined as "a person whose profession or reputation gives authority to a statement made by him or her".[21] As such, ASIC expects that the expert and commissioning party will ensure that:

(a) the expert's profession or reputation is relevant to the matters upon which the expert is to report;

(b) the expert holds the licences or authorities necessary for providing the type of advice sought; and

(c) the expert states in the report its qualifications and experience or, if the report is made by a corporation or firm, the qualifications and experience of the individuals responsible for preparing the report.[22]

ASIC notes that an expert's opinion should also be based on reasonable assumptions to reduce the risk of the report being misleading.[23]

ASIC expects an expert to:

(a) critically evaluate the information provided to it as is reasonable in the circumstances and as the law requires (the more material the information is to the conclusions reached by the expert, the greater the responsibility on the expert to be satisfied that the information is not materially inaccurate); and

(b) take note of any grounds held for questioning the truth, accuracy and completeness of the information (and make additional enquiries if there are indications suggesting that the information in question may not be reasonably relied on).[24]

An expert cannot limit its statutory liability for its report through disclaimers.[25]

An expert may take an indemnity from the commissioning party or any other person under which it is compensated for certain liability but such indemnity will not diminish the expert's

[17] ASIC Regulatory Guide 111, para RG 111.49.
[18] ASIC Regulatory Guide 111, para RG 111.49.
[19] ASIC Regulatory Guide 111, para RG 111.50.
[20] ASIC Regulatory Guide 111, para RG 111.62 and 111.63.
[21] Section 9 of the Corporations Act.
[22] ASIC Regulatory Guide 111, para RG 111.97.
[23] ASIC Regulatory Guide 111, para RG 111.58.
[24] ASIC Regulatory Guide 111, paras RG 111.76 and RG 111.77.
[25] ASIC Regulatory Guide 111, para RG 111.89.

responsibility to shareholders, nor will it reduce the expert's responsibility to ensure that it has reasonable grounds for its opinion and that the report is not misleading or deceptive.[26]

4 Takeovers Panel

The Takeovers Panel is established under Part 10 of the ASIC Act and has the powers set out in Part 6.10 of the Corporations Act in respect of proposals and transactions relating to the acquisition of control of, or substantial interests in, a company. It has the power to declare unacceptable circumstances in relation to such proposals and transactions[27] and the ability to make binding orders requiring action to address such circumstances.[28]

The Takeovers Panel has held that it will have regard to compliance with Regulatory Guide 111 in assessing the acceptability of expert reports prepared in a takeovers context and that such reports may be rejected by the Takeovers Panel if they do not comply with this Regulatory Guide.

Specifically, in *Bowen Energy Limited*[29] the Panel made a declaration of unacceptable circumstances in relation to an expert's report. Amongst other reasons, this was due to non-compliance with Regulatory Guide 111 which the Takeovers Panel considered gave rise to material deficiencies in the technical expert's report[30]. These deficiencies led to the Panel making a declaration of unacceptable circumstances and requiring preparation of a new independent expert report.

5. Legal Liability

An expert may incur liability for misleading and deceptive conduct if there are errors or misleading statements in their report. For example, in *Reiffel* v *ACN 075 839 226 Ltd*[31] where an expert was held to have engaged in misleading and deceptive conduct, and incurred civil liability, on account of statements and opinions made by them as independent expert in a prospectus where there was no proper or reasonable basis for such statements or opinions.

In addition an expert owes a duty of care to the company retaining it, to exercise reasonable care and skill in providing its advice.[32] A breach of this duty of care could result in the expert becoming liable pursuant to a negligence claim for any loss or damage suffered by the company and its shareholders in connection with the breach. *Duke Group* was a case where negligent preparation of a report (together with a breach of contract claim) resulted in the incurring of legal liability to the company for approximately twenty million dollars.

Please let us know if you have any queries in relation to this advice.

Johnson Winter & Slattery

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[26] ASIC Regulatory Guide 111, paras RG 111.93 and RG 111.94.

[27] Section 657A of the Corporations Act.

[28] Section 657D of the Corporations Act.

[29] [2009] ATP 19.

[30] [2009] ATP 19 at 70.

[31] [2003] FCA 194.

[32] *Pilmer v Duke Group (in liq)* (2001) 180 ALR 249.

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John is acknowledged as a leading corporate lawyer. For over 20 years John has advised extensively in mergers & acquisitions, corporate & securities law and corporate governance.

He is a past National Chairman of the Corporations Committee of the Law Council of Australia, a member of the BLS Executive and a former member of Finsia's (formerly the Securities Institute of Australia) National Board. John is currently a member of Finsia's Corporate Finance Advisory Group and member of the Companies Auditors & Liquidators Disciplinary Board.

In 2006, John was appointed as a member of the Australian Takeovers Panel, and during 2007 acted as Sitting President on three matters involving Consolidated Minerals Limited.

John has advised listed and private businesses and government business enterprises in a range of industry sectors on corporate law matters, including agricultural products, financial services and energy and resources.

John lectured for the Securities Institute's Mergers & Acquisitions course in the Graduate Diploma in Applied Finance and Investment from 1990 to 2005, and the Securities Law and Ethics subject from 1990 to 2002, as well as teaching seminar classes at the University of Adelaide Law School in Corporate Law in 2003 and 2004.

In 2009 and 2010 John was named by *Best Lawyer* as one of Australia's leading lawyers in the areas of Mergers and Acquisitions and Corporate/Governance.

Examples of Professional Experience

Mergers, Acquisitions and Reconstructions

- ABB Grain Limited
  - acting in relation to Viterra Inc.'s $1.6 billion scrip and cash scheme of arrangement (2009); and
  - merger discussions with AWB Limited (which would have formed Australia's largest agribusiness) (2008).
- Cephalon Inc – $318 million takeover bid for Arana Therapeutics Limited (2009).
- Incremental Petroleum Limited – takeover bids by Cooper Energy Limited and TransAtlantic Petroleum including Takeovers Panel proceedings (2008).
- Gerard Lighting Pty Ltd – $100 million takeover bid for Lighting Corporation Limited (2007-2008).
- Adelaide Bank Limited – $4 billion merger by scheme of arrangement with Bendigo Bank Limited (2007).
- Dolphete Pty Ltd – Takeovers Panel application concerning Becker Group Limited (2007).
- Santos Limited – $600 million takeover bid and proposed $960 million scheme of arrangement for Queensland Gas Company Limited including

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Takeovers Panel application (2006-2007).

- Envestra Limited
  - proposed joint bid with Origin Energy Limited and Cheung Kong Infrastructure for the assets of Duke Energy Australia Limited (2004);
  - proposed bid for the Dampier to Bunbury pipeline (2003-2004);
  - advice in relation to acquisition of substantial interest by Australian Pipeline Trust (2006-2007);
  - bid for Brisbane gas distribution network of Allgas (2006).
- Allco Equity Partners Limited – takeover bid for Baycorp Advantage Limited (2005).
- Bionomics Limited – acquisition of Iliad Chemicals (2005).
- Paragon Equity Limited – restructure to create Paragon Private Equity Fund (2005).
- International Wine Investment Fund
  - proposed restructure, internalisation of management and stapling (2004-2005);
  - proposed reconstruction (2003);
  - disposal of interest in BRL Hardy consequent upon BRL Hardy Constellation scheme of arrangement (2003).
- AA Scott Pty Ltd – takeover bid for Heggies Bulkhaul Limited (2004).
- AusBulk Limited – $1 billion merger by scheme of arrangement with ABB Grain Limited and United Grower Holdings Limited (2004).
- Adelaide Brighton Limited
  - takeover bid by Boral Limited (2003-2004);
  - acquisition of C&M Brick (2003);
  - acquisition of Rocla Pavers & Masonry (2003);
  - acquisition of Rocla flyash and transport business (2003);
  - acquisition of Premier Resources Limited (2002);
  - acquisition of Neil Mansell Concrete (2002).
- SA Liquor Distributors – takeover bid by Metcash including Takeovers Panel application (2002-2003).
- AusBulk Limited – takeover bid for Joe White Maltings Limited (2002).
- Banksia Wines Limited
  - follow up takeover bid by Lion Nathan Limited (2002);
  - takeover bid by Lion Nathan Limited (2001);
  - merger of St Hallett Wines and Tatachilla Winery and subsequent IPO (2000).
- Simeon Wines Limited – merger by scheme of arrangement with McGuigan Wines Limited (2002).

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- Laubman & Pank Holdings Limited
  - sale of M-E Hearing Systems (2001);
  - takeover bid by OPSM Protector Ltd (2001).
- BresaGen Limited (formerly Bresatec Limited)
  - acquisition of Cytogenesis Inc (2000);
  - sale of Research Products Division (1995-1996).
- University of Adelaide – sale of Camtech e-commerce business (2000).
- FH Faulding & Co Ltd
  - acquisition of Amfac and Healthlinks.net (2000);
  - acquisition of Minfos Systems (2000).
- Funds SA – $180 million sale of Adelaide Casino (2000).
- Australian Nut Processors Limited – takeover bid by Adrienne Enterprises (2000).
- Australian Wine & Horticulture Fund
  - takeover bid by AIDC (1999);
  - restructure of Berrivale Orchards Limited (1997).
- FH Faulding & Co Ltd
  - sale of Ultrafresh Mouth Wash and Breath Spray brand (1999);
  - acquisition of Soltec Research (1996).
- South Australian Department of Treasury and Finance – $3 billion restructure and privatisation of South Australian electricity industry (1998-2000).
- Simeon Wines Limited – Part A takeover bid for Australian Vintage Limited (1997).
- Woodroffe Industries Limited – Part A takeover bid by Hills Industries Limited (1997).
- North Flinders Mines Limited – Part A takeover bid by Normandy Mining Limited (1996).
- Normandy Mining Limited, PosGold Limited, Gold Mines of Kalgoorlie Limited and North Flinders Mines Limited – merger by way of schemes of arrangement (1995-1996).

Equity Capital Markets

- Gerard Lighting Group Limited – $177 million ASX listing, including $85 million in underwritten new equity (2010).
- Envestra Limited
  - $111 million capital raising by way of undocumented rights issue (2008-2009);
  - private placement (2002).

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- ABB Grain Limited – $187 million capital raising by way of private placement plus share purchase plan (2008).
- Adelaide Brighton Limited – $65 million rights issue (2002).
- Banksia Wines Limited – underwritten IPO and ASX Listing (2000).
- Macquarie Equity Capital Markets
  - underwriting rights issue by Chiquita Brands South Pacific (2000);
  - underwriting rights issue by Beach Petroleum NL (2000);
  - underwriting note issue by Australian Central Credit Union (2000).
- BresaGen Limited – underwritten IPO and ASX Listing (1999).
- Adelaide Cash Management Trust – conversion under Managed Investment Act (1999).
- Australian Wine & Horticulture Fund (formerly Wine Trust of Australia)
  - conversion under Managed Investment Act (1999);
  - option exercise prospectus (1999);
  - rights issue (1998);
  - IPO and ASX listing (1996).
- Adelaide Bank Limited – ASX listed Capital Note Issues (1997 and 1998).
- Adelaide Bank Limited – establishment of Adelaide Cash Management Trust (1997).

Corporate Litigation

- Southern Equities Holdings Limited – litigation concerning AGM and appointment of directors (1997).
- Auspine Limited (former SEAS Sapfor Limited) – capital restructure including court approved reduction of capital (1994).
- SGIC – disposal of interest in Amdel Limited, including Federal Court proceedings (1994).
- Jonal Properties Pty Ltd – purchase of remaining 50% in Aberfoyle Hub joint venture from MS McLeod Holdings Limited, including Supreme Court proceedings (1993-1994).
- Metals Exploration Limited – on-market takeover bid for SAMIC Limited, including Supreme Court trial and appeal (1993).
- Normandy Poseidon Limited – Administrative Appeal Tribunal and Federal Court administrative review proceedings relating to Part 6.7 of the Corporations Law (1993).
- SAGASCO Holdings Limited
  - tender offer for Magellan Petroleum Corporation (US), including Administrative Appeals Tribunal proceedings relating to downstream bid (1993);
  - takeover bid for Magellan Petroleum Australia Limited, including Queensland Supreme Court, Court of Appeal and High Court proceedings (1992-1993).

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- Independent Holdings Limited – successful takeover defence to bid by Foodland Associated Limited, including successful Administrative Appeals Tribunal proceedings (1991-1992).
- C-C Bottlers Limited – acquisition of Oasis Industries (NZ Coca Cola and Schweppes bottler), including joint venture with The Coca Cola Company (1989) and advice on and preparation for successful warranty claim against Lion Nathan Limited (vendor) (1990-1993).
- Mutual Community Limited – merger with National Mutual Life Association of Australasia, including Federal Court approved scheme of arrangement (1990).

Major Projects

- SA Water Corporation – Build, Own, Operate (BOO) arrangement for Wastewater Treatment Project at Aldinga, South Australia (1996).
- South Australian Health Commission and SA Department of Treasury & Finance – construction and private financing of new Mount Gambier Public Hospital (1995).

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Publications

Directors duties – ASIC v Rich – landmark or beacon? (2004) 22 C&SLJ 181

ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 111

Content of expert reports

October 2007

About this guide

This is a guide for any person who commissions, issues or uses an expert report.

It provides guidance on the content of an expert report and how an expert can help security holders make informed decisions about transactions.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This version was issued on 30 October 2007 and is based on legislation and regulations as at 30 October 2007.

This regulatory guide and Regulatory Guide 112 *Independence of experts* (RG 112) replace:

- Regulatory Guide 12 *Valuation reports and profit forecasts* (RG 12), issued 8 December 1993 and updated 3 March 1997 and 4 August 1997;
- Regulatory Guide 42 *Independence of expert's reports* (RG 42), issued 8 December 1993;
- Regulatory Guide 75 *Independent experts' reports to shareholders* (RG 75), issued 8 December 1993 and updated 5 February 1996 and 3 March 1997; and
- the following paragraphs of Regulatory Guide 74 *Acquisitions agreed to by shareholders* (RG 74): RG 74.15, RG 74.20–RG 74.29.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

A Overview

Key points

This guide gives ASIC's views on how an expert can help security holders make informed decisions about transactions.

It gives guidance to experts on how to draft an expert report that satisfies the requirements of the *Corporations Act 2001* (Cth) (Corporations Act).

This guide outlines our views on:

- how experts should analyse a proposed transaction (see Section B);
- the different valuation methodologies used by experts and the treatment of assumptions (see Section C);
- general requirements for all expert reports (see Section D); and
- the regulatory action we might take against an expert (see Section E).

Reports covered by this guide

RG 111.1 This guide focuses on reports prepared for transactions under Chs 5, 6 and 6A of the Corporations Act, whether the reports are required by the Corporations Act or are commissioned voluntarily. The principles in this guide may also be relevant to independent expert reports commissioned for other purposes, for example, specialist reports like geologist reports for inclusion in Ch 6D disclosure documents and Ch 7 product disclosure statements.

RG 111.2 This guide does not apply to independent or investigating accountant reports.

RG 111.3 Examples of transactions for which entities are required to commission an independent expert report or may do so voluntarily to assist security holders to make an informed choice are takeover bids, compulsory acquisitions and buy-outs, schemes of arrangement and capital reorganisations. See Table 1.

Table 1: Examples of transactions for which entities commission an independent expert report

Transaction	Circumstances
Takeover bids	• The target must commission an expert report when the bidder's voting power in the target is at least 30% of the target or when the bidder and the target have common directors: s640. • The bidder must commission an expert report when the consideration paid by the bidder for acquiring a pre-bid stake includes unquoted securities: s636(1)(h)(iii) and 636(2). • Targets often commission expert reports to assist security holders, even if there is no requirement to do so. • In joint bids the bidders must use their best endeavours to have the target engage an independent expert to prepare a report on whether the joint bid is fair and reasonable to target shareholders who are not associates of the bidders: see Regulatory Guide 159 *Takeovers, compulsory acquisitions and substantial holding notices* at RG 159.288 and RG 159.298.
Schemes of arrangement	• The scheme company must commission an expert report when the other party to the scheme holds at least 30% of the voting shares of the scheme company or when they have common directors: reg 5.1.01 and sch 8, cls 8303, 8306 of the Corporations Regulations 2001 (Cth) (Corporations Regulations). • Scheme companies often commission an expert report when transactions are complex or effect a takeover.
Compulsory acquisitions or buy-outs	The bidder in a compulsory acquisition must commission an expert report under s663B, 664C, 665B and 667A.
Acquisitions approved by security holders under item 7 of s611	The company commissions an expert report (or, if it has the expertise, a director's report to the same standard) to discharge the requirement to disclose all material information on how to vote on the resolution: item 7(b) of s611.
Selective capital reductions	An expert report should usually accompany the explanatory memorandum to satisfy the information requirements of fairness under s256C(4).
Related party transactions	An expert report may be supplied to members as part of the material to accompany the notice of meeting: s218, 219, 220 and 221.
Transactions with persons in a position of influence	Notices of meeting for approvals under ASX Listing Rule 10.10 must be accompanied by an expert report: ASX Listing Rule 10.10.2.
Demutualisations of financial institutions	An expert report must accompany a notice of meeting for a demutualisation of a financial institution or friendly society: sch 4, cl 29(4).
Buy-backs	If a company proposes to buy-back a significant percentage of securities or the holdings of a major shareholder, it should consider providing an independent expert report with a valuation of the shares: Regulatory Guide 110 *Share buy-backs* at RG 110.18 and RG 110.20.

B Analysing a transaction

Key points

An expert should focus on the issues facing the security holders for whom the report is being prepared: see RG 111.4–RG 111.6.

An expert should focus on the substance of the transaction rather than the legal mechanism used to achieve that purpose: see RG 111.7–RG 111.31.

Some transactions will require a different form of analysis, particularly:

- demergers and demutualisations (see RG 111.32–RG 111.37);
- approval of a sale of securities under item 7 of s611 (see RG 111.38–RG 111.43); and
- compulsory acquisitions and buyouts (see RG 111.44–RG 111.48).

A recommended approach

RG 111.4 In deciding on the appropriate form of analysis for a report, an expert should bear in mind that the main purpose of the report is to adequately deal with the concerns that could reasonably be anticipated of those persons affected by the proposed transaction. An expert should focus on the purpose and outcome of the transaction, that is, the substance of the transaction, rather than the legal mechanism used to effect the transaction.

RG 111.5 The Corporations Act requires an expert to express the opinion using particular language depending on the type of transaction. For example:

(a) whether a takeover bid is 'fair and reasonable' under s640;

(b) whether a scheme of arrangement is in 'the best interests of the members of the company' under sch 8, cl 8303 of the Corporations Regulations; and

(c) whether the proposed terms in the buy-out or acquisition notice give a 'fair value' for the securities under s667A(1).

RG 111.6 Nevertheless, the form of analysis an expert uses to evaluate a transaction should address the issues faced by security holders. The rest of this section sets out our guidance on the form of analysis an expert should use for particular types of transactions.

Control transactions

RG 111.7 A control transaction, when a person acquires, or increases, a controlling stake in a company, can be achieved by way of a number of different legal mechanisms, including, for example:

(a) a takeover bid under Ch 6;

(b) a scheme of arrangement under Pt 5.1;

(c) approval of an issue of shares using item 7 of s611; and

(d) a selective capital reduction or selective buy-back under Ch 2J.

Note 1: Ch 6 extends to listed managed investment schemes and listed bodies that are not companies. For the purposes of this regulatory guide, references to a 'company' in the context of Ch 6 takeovers can be read as references to these bodies or schemes, when appropriate.

Note 2: Not all item 7 of s611 transactions involve the issue of shares. For those item 7 transactions that do not, see RG 111.38–RG 111.43.

RG 111.8 It is important for an expert to focus on the substance of a control transaction, rather than the legal mechanism used to effect it.

Takeover bids

RG 111.9 It has long been accepted in Australian mergers and acquisitions practice that the words 'fair and reasonable' in s640 establish two distinct criteria for an expert analysing a control transaction:

(a) is the offer 'fair'; and

(b) is it 'reasonable'?

That is, 'fair and reasonable' is not regarded as a compound phrase.

RG 111.10 Under this convention, an offer is 'fair' if the value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer. This comparison should be made assuming 100% ownership of the 'target' and irrespective of whether the consideration is scrip or cash. The expert should not consider the percentage holding of the 'bidder' or its associates in the target when making this comparison. For example, in valuing securities in the target entity, it is inappropriate to apply a discount on the basis that the shares being acquired represent a minority or 'portfolio' parcel of shares.

RG 111.11 An offer is 'reasonable' if it is fair. It might also be 'reasonable' if, despite being 'not fair', the expert believes that there are sufficient reasons for security holders to accept the offer in the absence of any higher bid before the close of the offer.

RG 111.12 When deciding whether an offer is reasonable, an expert might consider:

(a) the bidder's pre-existing voting power in securities in the target;

(b) other significant security holding blocks in the target;

(c) the liquidity of the market in the target's securities;

(d) taxation losses, cash flow or other benefits through achieving 100% ownership of the target;

(e) any special value of the target to the bidder, such as particular technology, the potential to write off outstanding loans from the target, etc;

(f) the likely market price if the offer is unsuccessful; and

(g) the value to an alternative bidder and likelihood of an alternative offer being made.

RG 111.13 For example, a bidder who controls a target and makes a takeover bid may offer a price which is 'not fair' as it includes a minority discount. The offer price may, however, be greater than the price at which the securities were trading before the takeover bid was made. In such circumstances, it is appropriate for the expert to consider whether the market price may fall if the offer is unsuccessful: see RG 111.12(f). It would also be appropriate for the expert to consider the matters set out in RG 111.12(d) and RG 111.12(e) in assessing the likelihood that the bidder would increase its offer price, including to a price that an expert would assess as 'fair'.

RG 111.14 An expert concluding that an offer is not fair, but reasonable, should clearly explain the meaning of this opinion, why the expert has reached this conclusion and the significance of the conclusion to the decision to be made by security holders (e.g. what it might mean for the security holder's decision making). Otherwise, depending on the circumstances, the report might be misleading or deceptive.

Control transactions by way of a scheme of arrangement

RG 111.15 Schemes of arrangement can be used as an alternative to a Ch 6 takeover bid to achieve substantially the same outcome. In these circumstances, we expect the form of analysis to be substantially the same as for a takeover bid, even though the wording of the opinion will also be whether the proposed scheme is 'in the best interests of the members of the company'. This reflects that the legislative test for schemes of arrangement differs from that applicable to a Ch 6 takeover bid.

RG 111.16 When an expert report is required in a scheme of arrangement involving a change of control, the expert is expected to apply the analysis and provide an opinion as to whether the proposal is 'fair and reasonable' as set out in RG 111.9–RG 111.14 as if:

(a) the 'bidder' was the 'other party'; and

(b) the 'target' was the company that is the subject of the proposed scheme.

RG 111.17 If an expert would conclude that a proposal was 'fair and reasonable' if it was in the form of a takeover bid, it will also be able to conclude that the scheme is in the best interests of the members of the company.

RG 111.18 If an expert would conclude that the proposal was 'not fair but reasonable' if it was in the form of a takeover bid using the analysis described in RG 111.9–RG 111.14, it is still open to the expert to also conclude that the scheme is 'in the best interests of the members of the company'. The expert should clearly say that the consideration is not equal to or greater than the value of the securities the subject of the scheme, but there are sufficient reasons for security holders to vote in favour of the scheme in the absence of a higher offer.

RG 111.19 If an expert concludes that a scheme proposal is 'not fair and not reasonable', then the expert would conclude that the scheme is not in the best interests of the members of the company.

RG 111.20 When a scheme of arrangement is used to acquire or increase a party's control, the report should address the interests of members who are bound to give up rights under the scheme. The expert should separately consider the interests of each class of those members under the scheme.

Other control transactions

RG 111.21 An issue of shares by a company otherwise prohibited under s606 may be approved under item 7 of s611 and the effect on the company's shareholding is comparable to a takeover bid. Examples of such issues approved under item 7 of s611 that are comparable to takeover bids under Ch 6 include:

(a) a company issues securities to the vendor of another entity or to the vendor of a business and, as a consequence, the vendor acquires over 20% of the company incorporating the merged businesses. The vendor could have achieved the same or a similar outcome by launching a scrip takeover for the company; and

(b) a company issues securities in exchange for cash and, as a consequence, the allottee acquires over 20% of the company. The allottee could have achieved the same or a similar outcome by using a cash-rich entity to make a scrip takeover bid for the company.

RG 111.22 If this is the case, an expert should apply the analysis outlined in RG 111.9–RG 111.14, that is, the transaction should be analysed as if it was a takeover bid under Ch 6. However, references to, for example, the 'bidder' and the 'target' should be taken to mean the 'allottee' and 'company' respectively.

RG 111.23 An issue of shares for cash may have other benefits that should be considered in deciding whether the transaction is reasonable. These benefits may include:

(a) the provision of new capital to exploit business opportunities;

(b) a reduction in debt and interest payments; or

(c) a needed injection of working capital.

RG 111.24 There may be circumstances in which the allottee will acquire 20% or more of the voting power of the securities in the company following the allotment or increase an existing holding of 20% or more, but does not obtain a practical measure of control or increase its practical control over that company. If the expert believes that the allottee has not obtained or increased its control over the company as a practical matter, then the expert could take this outcome into account in assessing whether the issue price is 'reasonable' if it has assessed the issue price as being 'not fair' applying the test in RG 111.10.

RG 111.25 A transaction otherwise prohibited under s606 in respect of which approval is sought under item 7 of s611 will not always involve the issue of shares. For the analysis of other item 7 of s611 transactions, see RG 111.38–RG 111.43.

RG 111.26 Similar considerations apply in relation to control transactions by way of a selective capital reduction or selective buy-back under Ch 2J.

Assessing non-cash consideration in control transactions

RG 111.27 If the bidder is offering non-cash consideration in a control transaction, the expert should examine the value of that consideration and compare it with the valuation of the target's securities, whether the transaction is effected by a takeover bid, a scheme of arrangement or an issue of shares.

RG 111.28 The comparison should be made between the value of the securities being offered (allowing for a minority discount) and the value of the target entity's securities, assuming 100% of the securities are available for sale. This comparison reflects the fact that:

(a) the acquirer is obtaining or increasing control of the target; and

(b) the security holders in the target will be receiving scrip constituting minority interests in the combined entity.

However, the expert may need to assess whether a scrip takeover is in effect a merger of entities of equivalent value when control of the merged entity will be shared equally between the 'bidder' and the 'target'. In this case, the expert may be justified in using an equivalent approach to valuing the securities of the 'bidder' and the 'target'.

RG 111.29 If the expert uses the market price of securities as a measure of the value of the offered consideration, the expert should consider and comment on:

(a) the depth of the market for those securities;

(b) the volatility of the market price; and

(c) whether or not the market value is likely to represent the value if the takeover bid is successful.

RG 111.30 For example, trading after a bid is announced may reflect some of the benefits of the combined entity, depending on whether the market has confidence that the transaction will proceed.

RG 111.31 If, in a scrip bid, the target is likely to become a controlled entity of the bidder, the bidder's securities can also be valued assuming a notionally combined entity. However, the expert should still allow for the fact that accepting holders are likely to hold minority interests in that combined entity. The comparison should include the assets and liabilities of the target and the dilution effect of the acquisition on the target's earnings, asset backing and dividends. The expert should also discuss the bases for calculating the dilutions.

Note: Reverse takeovers (either by takeover bid or scheme of arrangement) can raise special issues: see Regulatory Guide 142 *Schemes of arrangement and ASIC review* (RG 142) at RG 142.9.

Demergers and demutualisations

RG 111.32 Demergers and demutualisations might not involve:

(a) a change in the underlying economic interests of security holders;

(b) a change of control; or

(c) selective treatment of different security holders.

RG 111.33 In the absence of these factors, the issue of 'value' may be of secondary importance (particularly in demutualisations). The expert should provide an opinion as to whether the advantages of the transaction outweigh the disadvantages. In some cases, it might still be appropriate to carry out a valuation. In a demerger, the expert may still choose to value the demerged businesses to test whether the value of the sum of the parts (the demerged entities) is greater or less than the whole (the existing entity).

RG 111.34 If the demerger or demutualisation involves a scheme of arrangement and the expert concludes that the advantages of the transaction outweigh the disadvantages, the expert should say that the scheme is in the best interests of the members.

RG 111.35 In a demerger, security holders will typically have to balance issues such as the benefits of a greater focus afforded to the demerged entities against increased costs and reduction in diversified earnings streams.

RG 111.36 In a demutualisation, the advantages and disadvantages to be considered might include questions of unlocking value for members and greater management accountability as reasons to demutualise, as compared to the loss of the benefits of being a mutual organisation.

RG 111.37 An expert might need to consider whether using the form of analysis described at RG 111.9–RG 111.14 is appropriate when demergers and demutualisations involve one or more of:

(a) a change in the underlying economic interests of security holders;

(b) a change of control; or

(c) selective treatment of different security holders.

Approval of a sale of securities under item 7 of s611

RG 111.38 Approval for a sale of securities that would otherwise contravene s606 may be sought under item 7 of s611. Item 7 of s611 envisages that security holders not associated with such a transaction may approve it. In doing so, these security holders may be forgoing:

(a) the opportunity of receiving a takeover bid; and

(b) sharing in any premium for control.

RG 111.39 The expert should identify the advantages and disadvantages of the proposal to security holders not associated with the transaction. In contrast with the analysis for an issue of shares approved under item 7 of s611, the expert should provide an opinion either:

(a) that the advantages of the proposal outweigh the disadvantages; or

(b) that the disadvantages of the proposal outweigh the advantages.

RG 111.40 A specific issue the expert should determine is whether the vendor is to receive a premium for control.

RG 111.41 The greater the control premium, the greater the advantages of the transaction to the non-associated holders would need to be to support a finding that the advantages of the proposal outweighed the disadvantages. These other advantages may come, for example, from a better long-term

profit outlook as the incoming security holder offers superior management skills.

RG 111.42 The expert should also inquire whether further transactions are planned between the entity, the vendor or any of their associates. If any are contemplated, the expert should determine whether those transactions would be on an arm's length basis. If not, an implication arises that they may compensate a vendor for a price that is too low.

RG 111.43 An expert should also consider whether any proposed acquisition by way of sale, if approved, might deter the making of a takeover bid for the entity.

Compulsory acquisitions and buy-outs

RG 111.44 Chapter 6A prescribes the steps an expert must take in reaching an opinion for compulsory acquisitions and buy-outs. Section 667A(1) requires an expert to:

(a) provide an opinion on whether the proposed terms in the buy-out or acquisition notice give a 'fair value' for the securities; and

(b) set out the reasons for its opinion.

RG 111.45 To determine what is 'fair value', s667C requires that an expert:

(a) first assess the value of the entity as a whole;

(b) then allocate that value among the classes of issued securities in the company (taking into account the relative financial risk and the voting and distribution rights of the classes); and

(c) then allocate the value of each class pro rata among the securities in that class (without allowing any premium or applying a discount for particular securities or interest in that class).

RG 111.46 In determining the fair value for securities, an expert must also take into account the prices paid for securities in that class in the previous six months: s667C(2).

RG 111.47 The weight of judicial authority is that an expert should not reflect 'special value' that might accrue to the acquirer (e.g. *Capricorn Diamonds Investments Pty Ltd v Catto* (2002) 41 ACSR 376 at 431; *Winpar Holdings Ltd v Austrim Nylex Ltd* [2005] VSCA 211 at [11]–[37]; *Teh v Ramsay Centauri* (2002) 42 ACSR 354 at 359). In practice, the issue of 'special value' might not be a critical issue. Special value might not be material once it has been allocated pro rata to each security in the class, including the securities of the party seeking to make the compulsory acquisition. An expert should not add any premium for forcible divestment: see *Capricorn* at 432.

Note: Similar considerations apply as to whether consideration under a capital reduction 'is fair and reasonable to the company's shareholders as a whole': see s256B(1)(a) and *Re Goldfields Kalgoorlie; Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2000) 34 ACSR 737 at [69].

RG 111.48 Our approach to nominating experts to provide valuations under Ch 6A is set out in RG 159 at RG 159.107–RG 159.118.

C Methodologies and assumptions

Key points

An expert should:

- if possible use more than one valuation methodology and compare the values derived from using different methodologies to minimise the risk that the opinion is unreliable; and
- justify its choice of methodologies and describe the methods used: see RG 111.49–RG 111.57.

An expert's opinion should be based on reasonable assumptions and all material assumptions should be disclosed: see RG 111.58–RG 111.61.

An expert should usually give a range of values and that range should be as narrow as possible: see RG 111.62–RG 111.63.

An expert might need to value individual assets in certain circumstances: see RG 111.64–RG 111.67.

Choice of methodology

RG 111.49 An expert should use its skill and judgment to select the most appropriate methodology or methodologies in its report. The expert must have a reasonable (or tenable) basis for choosing its valuation methodologies: *Re Matine* (1998) 28 ACSR 268 at 290–291. An inappropriate choice might be misleading: *Re EPHS Ltd* [2002] ATP 12. It might also lead to liability because the expert did not take sufficient care and skill in the preparation of the report: *Duke Group Ltd v Pilmer* (1999) 31 ACSR 213.

RG 111.50 We consider that an expert should, when possible, use more than one valuation methodology. We consider that this reduces the risk that the expert's opinion is distorted by its choice of methodology. We also consider that an expert should compare the figures derived from using the different methodologies and comment on any differences.

RG 111.51 However, we will not prescribe the valuation methodologies that an expert should use in preparing its report since an expert should exercise its own skill and judgment to choose methodologies that are appropriate in the circumstances of the entity or the asset being valued.

RG 111.52 An expert should justify its choice of methodology or methodologies (including when the expert has used only one methodology, the basis for doing so) and describe the method or methods used in the report. We consider that an expert report that does this allows security holders to better

understand the expert report and determine the weight to be attached to the report. It also allows another expert, professional adviser or institutional investor to replicate the expert's work and assess the valuation.

RG 111.53 It is generally appropriate for an expert to consider using the following methodologies:

(a) the discounted cash flow method and the estimated realisable value of any surplus assets;

(b) the application of earnings multiples (appropriate to the business or industry in which the entity operates) to the estimated future maintainable earnings or cash flows of the entity, added to the estimated realisable value of any surplus assets;

(c) the amount that would be available for distribution to security holders on an orderly realisation of assets;

(d) the quoted price for listed securities, when there is a liquid and active market and allowing for the fact that the quoted price may not reflect their value, should 100% of the securities be available for sale; and

(e) any recent genuine offers received by the target for any business units or assets as a basis for valuation of those business units or assets.

Note: Some valuation methodologies include a premium for control while others do not. An expert needs to ensure that the choice of methodology or methodologies is appropriate for the circumstances of the transaction.

RG 111.54 In applying the above methodologies, it would be open to an expert to have regard to the amount an alternative bidder might be willing to offer if all the securities in the target were available for purchase, for example, in selecting earnings multiples and underpinning any overall judgment as to value.

RG 111.55 An expert should not take into account highly speculative alternative proposals which are so unformulated that no sensible value could be placed on them.

RG 111.56 If an entity has recently conducted a sale process without success or has been 'in play' for some period without an alternative bid emerging, it may be possible to comment that no alternative acquirer appears likely to offer a higher price.

Option valuations

RG 111.57 The most commonly used methodologies for valuing unlisted or thinly traded options are the Binomial Model and the Black-Scholes Model. In selecting an approach, an expert should assess whether the assumptions used in the methodology are appropriate for the options being valued.

Assumptions

RG 111.58 An expert's opinion should be based on reasonable assumptions. This reduces the risk that the report will be misleading: s670A(2); s12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act); *MGICA (1992) Ltd v Kenny & Good Pty Ltd* (1996) 140 ALR 313 at 356; *RAIA Insurance Brokers v FAI General Insurance Co Ltd* (1993) 112 ALR 511 at 522.

RG 111.59 An expert should disclose all material assumptions on which its report is based. This allows security holders to assess the reasonableness of the report and its main uncertainties: *Re BNQ Sugar Pty Ltd and Others* (1994) 12 ACSR 695 at 702; *GIO Australia Holdings Pty Ltd v AMP Insurance Investment Holdings Pty Ltd* (1998) 29 ACSR 584 at 621–622.

RG 111.60 The material assumptions disclosed should be specific and definite. All-embracing assumptions of no specific relevance to the entity being valued should not be included (e.g. the continued absence of war or the non-occurrence of natural disasters). However, assumptions concerning specific future economic conditions (such as assumed interest rates, exchange rates and commodity prices) and the assessment of their impact on the report should be disclosed.

RG 111.61 If changes in material assumptions are likely to materially impact on a report's valuation (e.g. changes in the exchange rate or interest rate assumptions), an expert should consider including a sensitivity analysis which sets out the impact of such changes.

> Note: See Regulatory Guide 170 *Prospective financial information* (RG 170) at RG 170.65 and RG 170.66.

Value ranges

RG 111.62 An expert should usually give a range of values. The value of securities is typically subject to uncertainty and volatility. Placing a precise dollar value on them is likely to imply a misleading accuracy to a valuation.

RG 111.63 Nevertheless, the range of values should be as narrow as possible. If an expert cannot give a narrow range because of uncertainty (e.g. start-up companies), the expert should prominently explain in its report what factors create this uncertainty and how the expert is able to justify its findings despite the uncertainty. In our view, a broad range of values undermines the usefulness of the report.

Valuing assets

RG 111.64 An expert might need to value individual assets in undertaking the analysis required to prepare its report, for example, if the assets are considered 'surplus' to other business activities being valued. In valuing individual assets, an expert may need to quantify and discuss any material differences between its valuation and the market value of the asset used for accounting purposes.

RG 111.65 An expert may also need to assess the carrying value of an entity's assets if the primary valuation methodology it has employed results in a value that is less than the entity's reported net assets (after allowing for reasonable realisation costs).

RG 111.66 In such circumstances, the expert should ensure that it has the expertise to value the assets (e.g. to value real property or exploration mining tenements) or retain a specialist to do so.

RG 111.67 Real property assets that are planned or are in the process of development should be valued on the basis of their current market value rather than on an 'as complete' basis.

D Other key requirements

Key points

An expert report should help security holders make their decision by clearly disclosing key information: see RG 111.68–RG 111.73.

An expert's opinion should be based on reasonable grounds. These grounds should be discussed in the report: see RG 111.74–RG 111.83.

An expert might need to act on changes in circumstances after issuing its report: see RG 111.84–RG 111.86.

Particular considerations apply to the inclusion of certain information (e.g. disclaimers): see RG 111.87–RG 111.96.

An expert should have the relevant expertise to prepare the expert report: see RG 111.97–RG 111.102.

Clear, concise and effective communication

RG 111.68 An expert report should help security holders make their decision. The report should:

(a) address the varying information needs of a report's audience;

(b) clearly explain the meaning of the expert's opinion and the significance of that opinion to the decision to be made by security holders;

(c) highlight key information;

(d) be easy to navigate and understand (e.g. through the use of content tables, signposting, cross-references, numbered sections, sub-sections and the avoidance of jargon); and

(e) be as brief as possible.

RG 111.69 An expert report should only contain information that relates directly to the decision to be made by security holders. Including extraneous information in an expert report undermines the effectiveness of that report. Santow J dealt with this issue in *Re Australian Co-operative Foods Ltd* (2001) 38 ACSR 71 at 77 in the following terms:

> Experts are responsible for what they say in their reports. They must ensure that their reports deal adequately with the kind of concerns that could reasonably be anticipated from those affected by the scheme, in reporting on whether the relevant scheme proposal is fair and reasonable from their viewpoint … This is so those members can then make an informed decision with the benefit of a report that is as simple, clear and useful as possible. A plethora of peripheral information is more likely to distract than illuminate.

RG 111.70 For example, an analysis of the industry in which the company (i.e. the subject of the opinion) operates might be useful. However, copying material out of an industry research database may merely add to the length of reports. An expert should include an analysis of the material and relate the material directly to its opinion.

Technical terms

RG 111.71 Technical terms should be avoided when possible. If the expert uses technical terms, it should use them consistently in a report and consistently with the way they are used in the relevant industry. When appropriate, the expert should provide a glossary, especially when the definition or interpretation of specific terms is central to its report.

Concise or short form expert report

RG 111.72 We encourage an expert to consider preparing a concise or short form expert report. The commissioning party would make a longer expert report containing additional, more technical or detailed information available on request free of charge or ensure it is accessible online. This reflects a developing market practice.

RG 111.73 The concise report would still need to contain sufficient information to help security holders make their decision. The concise report should include the information that we emphasise in the rest of this guide and in Regulatory Guide 112 *Independence of experts* (RG 112) (e.g. material assumptions). If the longer report contained any 'surprises' for the security holder who only read the concise report, this would indicate the concise report was inadequate or misleading. Table 2 contains examples of types of information that an expert might consider including and leaving out of the concise report. Determining what information to include in the concise report and what to leave out is a matter for the expert's professional judgement in the particular circumstances of the report. However, we are happy to work with experts on these issues.

Table 2: Examples of information that an expert might consider putting in and leaving out of a concise expert report

Include in the concise expert report	• Expert's conclusion • Meaning of conclusion and significance for the decision to be made • Summary of reasons for conclusion • Summary of valuation including: – methodologies used; – material assumptions; and – a justification of these • Financial Services Guide
Leave out of the concise expert report	• Industry overview • Disclaimers • Detailed financial information • Detailed profile of parties to the transaction • Qualifications, declarations (e.g. indemnities) and consents • Detailed share price analysis • Details of capital structure (e.g. shareholder spread and directors' relevant interests if not linked to the expert's analysis) • List of previous ASX announcements • List of sources of information

Statements should be supportable

Reasonable grounds

RG 111.74 An expert's opinion should be based on reasonable grounds. These grounds should be set out in the report.

RG 111.75 We consider that setting out the reasons for the opinion will assist security holders to understand the expert's opinion, to assess the weight to attach to that opinion and to evaluate the validity of the expert's conclusions: s636(2); 640(1); 667A(1)(c); sch 8, cl 8303 of the Corporations Regulations and *Makita (Australia) Pty Ltd v Sprowles* (2001) 52 NSWLR 705 at 729 and following. Further, security holders cannot make an informed decision without the benefit of 'sufficient supporting information': *Australian Co-operative Foods* at 77.

Review of information

RG 111.76 We expect an expert to:

(a) critically evaluate the information provided to it; and

(b) take note of any grounds held for questioning the truth, accuracy and completeness of the information.

RG 111.77 An expert should conduct such critical analysis of the information on which it relied to prepare the report as is reasonable in the circumstances and as the law requires: *Australian Co-operative Foods* at 77. The more material the information is to the conclusions reached by the expert, the greater the responsibility on the expert to be satisfied that the information is not materially inaccurate. If there are indications suggesting that the information in question may not be reasonably relied on, then the expert should make additional enquiries. We do not expect an expert to conduct an audit of the subject matter of the report. If an expert cannot satisfy itself that it is reasonable to rely on otherwise material information, it should say this in its report with an explanation. In some circumstances, an expert may need to consider not relying on such information.

RG 111.78 For example, the expert must review directors' valuations and management accounts, partly to detect changes in the way those valuations and accounts have been prepared from period to period: see RG 111.80. If there are no indications of irregularities or omissions, an expert will ordinarily be entitled to take at face value valuations previously prepared by outside experts, audited financial statements and the accounting records of the company. An expert may also rely on management accounts if it has established reasonable grounds: see RG 111.80.

Prospective financial information

RG 111.79 An expert should not include prospective financial information (including forecasts and projections) in its report unless there is a reasonable basis for that information. Otherwise the opinion may be misleading.

RG 111.80 An expert should make sufficient inquiries to satisfy itself that prospective financial information on which it has relied was prepared on a reasonable basis. It is important that those producing such information have used methods of analysis and presentations previously used by the company, and have not used new systems or approaches which favour their objectives. If there are any material variations in method or presentation, the expert should adjust for or comment on them in the report.

RG 111.81 When an expert includes prospective financial information in its report, the report should include details of:

(a) the assumptions used;

(b) the extent of inquiries and research undertaken by the expert and the compiler of that information; and

(c) the specific period to which the information relates and the reason for the use of that period.

RG 111.82 RG 170 gives detailed guidance on what we consider is a reasonable basis for stating prospective financial information. While RG 170 is expressed to

apply to fundraising documents under Ch 6D and 7, it provides useful guidance for inclusion of prospective financial information in expert reports.

RG 111.83 However, we recognise that using discounted cash flow (DCF) methodology will involve the use of prospective financial assumptions over a longer period than the two year period in RG 170: see RG 170.18 and RG 170.29. So long as the focus of the disclosure in the expert report is on the valuation rather than the prospective financial information that supports it, the expert does not need to commission an independent accountant report for the DCF methodology: see RG 170.18(c). However, the expert should undertake a critical analysis of the prospective financial information used in applying the DCF methodology.

Changes in circumstances

RG 111.84 An expert who has delivered its report to the commissioning party should notify that party as soon as possible if the expert becomes aware of a significant change affecting the information in its report or if the expert believes that a material statement in the report is misleading or deceptive.

RG 111.85 When a material change in circumstances has arisen since a report was prepared, a failure by the expert to provide a supplementary report to its client may constitute misleading or deceptive conduct. Security holders will rely on an expert report when making their decision, not when they first receive the report: *ASIC v Solution 6 Holdings Ltd* (1999) 30 ACSR 605 at 611. If an expert becomes aware of a material change in circumstances, then depending on the circumstances, it may be appropriate for a commissioning party to send a supplementary report, even if security holders would receive the report:

(a) shortly before a meeting is held; or

(b) towards the end of an offer period.

See *Troy Resources NL v Taipan Resources NL* (2000) 36 ACSR 197.

RG 111.86 Changes affecting valuations in reports are more likely to trigger the supplementary report obligation than tactical events in the progress of transactions, for example, the level of acceptances in a bid.

Inclusion of other information

Confidential information

RG 111.87 While an expert should not omit material information from its report merely because it is confidential, the expert may be able to adequately support an opinion by careful disclosure without revealing confidential information.

Disclaimers

RG 111.88 The purpose of an expert report is to give security holders an assessment on which they can rely. A disclaimer defeats this purpose.

RG 111.89 An expert cannot limit its statutory liability for the report through disclaimers (e.g. that the expert will not be liable for any loss incurred through reliance on its report). An expert report that purports to exclude the expert from liability may be misleading.

RG 111.90 An expert should consider refusing to give a report when it has not been given:

(a) sufficient information or unimpeded access to an entity's records; or

(b) enough time to prepare the report.

RG 111.91 When an expert decides that its report will assist security holders despite limitations that the expert cannot resolve (e.g. because the expert does not have time to investigate the reliability of certain information), the expert should prominently explain the nature of the uncertainties and the impact on its opinion so that security holders can assess what weight to attach to the opinion.

RG 111.92 When an expert is retained to provide a report on a limited matter, the expert may disclaim responsibility for matters outside the scope of its retainer.

Indemnities

RG 111.93 An expert may take an indemnity from the commissioning party (or any other person) under which it is to be compensated for certain liability. An acceptable indemnity would cover liability that arises because:

(a) the expert relied on information provided by the person; or

(b) the person did not provide the expert with material information.

RG 111.94 Such an indemnity will not diminish the liability of an expert to security holders. Nor will it reduce the expert's responsibility to ensure that it has reasonable grounds for its opinion and that the report is not misleading or deceptive.

RG 111.95 An expert report that implies that an indemnity relieves the expert from liability to security holders is potentially misleading. ASIC expects reports to explain the effect of any indemnity.

Additional disclosures

RG 111.96 An expert should also disclose to security holders, to the extent necessary to help them assess what weight to give to reports:

(a) the source of material used in the reports;

(b) the inquiries made by the expert;

(c) any unacceptable or unusual time constraints the expert worked under;

(d) whether the expert is dissatisfied with the quality of the information used for the report; and

(e) whether any concerned party to the relevant transaction has refused to provide adequate:

(i) access to information; or

(ii) explanations;

if the information or the explanations might have impacted on the report's conclusions.

Expertise

RG 111.97 ASIC expects an expert preparing an expert report to be, in fact, an expert in the relevant field. Section 9 defines an expert as 'a person whose profession or reputation gives authority to a statement made by him or her'. To this end, we expect an expert and the commissioning party to ensure that:

(a) the expert's profession or reputation is relevant to the matters upon which the expert is to report;

(b) the expert holds the licences or authorities necessary for providing the type of advice sought; and

(c) the expert states in the report its qualifications and experience or, if the report is made by a corporation or firm, the qualifications and experience of the individuals responsible for preparing the report.

RG 111.98 Gyles J observed in *Reiffel v ACN 075 839 266 Ltd* (2003) 45 ACSR 67 at 87:

> It is implicit … that such an expert will exercise the care, skill and judgment appropriate to the relevant field of expertise in forming and expressing the opinion.

RG 111.99 For technical matters beyond the expert's expertise, an expert should retain a specialist to advise them (e.g. a geologist to provide an opinion on recoverable ore the subject of mining tenements): see RG 112 at RG 112.58–RG 112.60.

RG 111.100 An expert should ensure that staff preparing and supervising the preparation of the report have sufficient skill, knowledge and experience to perform the expert's role.

RG 111.101 Expert reports typically constitute the giving of financial product advice so an expert must hold an Australian financial services (AFS) licence. An AFS licensee should have sufficient human and technological resources to

provide the services specified in its licences and should ensure its staff are adequately trained and competent to provide those services: s912A(1).

> Note: ASIC has taken action against an expert when the expert lacked the expertise to complete the task, failed to comply with the law and did not meet standards of good practice: see Media Release MR 01-421 *ASIC clips Falconer's wings*.

RG 111.102 Detailed guidance on how we consider these licence obligations can be met are contained in Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104), Regulatory Guide 105 *Licensing: Organisational competence* (RG 105) and Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146).

E Regulatory action

Key points

We will consider regulatory action if we consider there are material issues with the content of an expert report or have concerns about the independence of an expert.

RG 111.103 We will consider regulatory action if we consider that there are material issues with the content of the report (e.g. as to the adequacy and the completeness of the expert's analysis) or if we have concerns about the independence of an expert.

RG 111.104 We might write to the expert or the commissioning party or both to raise concerns or request changes to an expert report. However, when delay might prejudice the interests of security holders or the market, we might take enforcement action without consulting the expert or the commissioning party.

RG 111.105 The action we might take could be one or more of the following:

(a) in a takeover bid, an application to the Takeovers Panel for a declaration of unacceptable circumstances;

(b) in a scheme of arrangement, opposition to the scheme at a court hearing;

(c) action for contravention of misleading or deceptive conduct provisions;

(d) action by us to revoke, suspend the expert's licence or add a condition after a hearing: s915C; or

(e) action by us to cease or suspend nominating the expert to prepare reports in compulsory acquisitions: s667AA and RG 159.107.

Key terms

Term	Meaning in this document
AFS licence	Australian financial services licence
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001* (Cth)
ASX	Australian Securities Exchange Limited
bidder	The meaning given to that term in s9
Corporations Act	*Corporations Act 2001* (Cth)
Corporations Regulations	Corporations Regulations 2001 (Cth)
expert	The meaning given to that term in s9
s648A	A section of the Corporations Act (in this example, numbered 648A)
sch 4	A schedule of the Corporations Act (in this example, numbered 4)
scheme of arrangement	A scheme of arrangement conducted under Pt 5.1
securities	The meaning given to that term in s9
security holder	The holder of interests or securities
target	The meaning given to that term in s9

Related information

Headnotes

Experts, expert report, analysis of control transactions, substance of transaction not legal mechanism used, assumptions, methodology, valuing assets, clear communication, incorporation by reference, supportable statements, prospective financial information, disclaimers, indemnities, expertise.

Regulatory guides

RG 74 *Acquisitions agreed to by shareholders*

RG 104 *Licensing: Meeting the general obligations*

RG 105 *Licensing: Organisational competence*

RG 110 *Share buy-backs*

RG 112 *Independence of experts*

RG 142 *Schemes of arrangement and ASIC review*

RG 146 *Licensing: Training of financial product advisers*

RG 159 *Takeovers, compulsory acquisitions and substantial holding notices*

RG 170 *Prospective financial information*

Legislation

Corporations Act 2001 (Cth), s9, 218, 219, 220, 221, 256C(4), 606, item 7(b) of 611, 636(1)(g), 636(1)(h)(iii), 636(2), 640, 663B, 664C, 665B, 667A, 667C, 670A(2), 766B(3), 766(4), 912A(1) and sch 4, cl 29(4).

Corporations Regulations 2001 (Cth), reg 5.1.01, sch 8 cl 8303 and 8306

Australian Securities and Investments Commission Act 2001 (Cth), s12DA

Cases

ASIC v Solution 6 Holdings Ltd (1999) 30 ACSR 605

Re Australian Co-operative Foods Ltd (2001) 38 ACSR 71

Re BNQ Sugar Pty Ltd and Others (1994) 12 ACSR 695

Capricorn Diamonds Investments Pty Ltd v Catto (2002) 41 ACSR 376

Duke Group v Pilmer (1999) 31 ACSR 213

Re EPHS Ltd [2002] ATP 12

Re Goldfields Kalgoorlie; Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd (2000) 34 ACSR 737

GIO Australia Holdings Pty Ltd v AMP Insurance Investment Holdings Pty Ltd (1998) 29 ACSR 584

Makita (Australia) Pty Ltd v Sprowles (2001) 52 NSWLR 705

Re Matine (1998) 28 ACSR 268

MGICA (1992) Ltd v Kenny & Good Pty Ltd (1996) 140 ALR 313

RAIA Insurance Brokers v FAI General Insurance Co Ltd (1993) 112 ALR 511

Reiffel v ACN 075 839 266 Ltd (2003) 45 ACSR 67

Teh v Ramsay Centauri (2002) 42 ACSR 354

Troy Resources NL v Taipan Resources NL (2000) 36 ACSR 197

Winpar Holdings Ltd v Austrim Nylex Ltd [2005] VSCA 211

Consultation papers and reports

Consultation Paper 62 *Better experts' reports* (CP 62)

Media releases

MR 01-421 *ASIC clips Falconer's wings*

Miscellaneous

ASX Listing Rule 10.10.2