



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 62

Better experts' reports

February 2005

Your comments

We invite your comments on the *proposals and issues for consideration* in this paper.

We will treat your comments as public unless you say otherwise.

Comments are due by Wednesday 27 April 2005 and should be sent to:

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What this policy proposal is about

1 We are reviewing our policy on experts. Experts' reports are commissioned by a person (the client) under requirements of the *Corporations Act 2001* (the Act) or voluntarily to provide investors with an independent professional assessment of a transaction.

2 The aims of this review are to:

- (a) address a continuing public perception that experts' reports might not express a view sufficiently independent from the interests of the client;
- (b) promote higher quality experts' reports that are clear, concise and effective;
- (c) update our experts policy to reflect current issues and legislative amendments—e.g. *Corporate Law Economic Reform Program Act 1999*—and court authority since our experts policies were released and last reviewed in the 1990s; and
- (d) consolidate our experts policy statements and practice notes.

3 We are also revisiting our experts policy in light of reforms to promote transparency and accountability addressing conflicts of interest under the *Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act 2004* (CLERP 9 Act).

4 The purpose of this policy proposal paper (PPP) is to review particular issues and recent developments rather than to reconsider our policies on experts as a whole. This PPP should be read with our existing experts policies: see para 7 below.

5 This policy proposal paper covers:

- (a) independence (**Section A**);
- (b) the expert's role (**Section B**);
- (c) quality and content issues (**Section C**); and
- (d) regulatory action (**Section D**).

6 Once we have considered your comments, we propose to issue two new policy statements replacing our existing policies. These will cover:

- (a) independence; and
- (b) quality and content.

Existing policies

7 The existing practice notes and policy statements on experts that we are reviewing are:

- (a) Practice Note 42 *Independence of experts' reports* [PN 42]
- (b) Practice Note 43 *Valuation reports and profit forecasts* [PN 43]
- (c) Policy Statement 74 *Acquisitions agreed to by shareholders* [PS 74]
- (d) Policy Statement 75 *Independent expert reports to shareholders* [PS 75].

When are experts' reports commissioned?

8 Examples of circumstances where a client must commission, or commonly commissions, an expert's report are in a:

- (a) takeover bid—the target must commission a report where the bidder has at least 30% of the target or there are common directors (s640);
- (b) takeover bid—the bidder must commission a report where consideration for a pre-bid stake was unquoted securities (s636(1)(h)(iii) and 636(2));
- (c) scheme of arrangement—the company must commission a report where the other party to the reconstruction has at least 30% of the company or there are common directors (reg 5.1.01 and Corporations Regulations Schedule 8 cl 8303);
- (d) a hostile takeover bid—a target often voluntarily commissions an expert's report;
- (e) scheme of arrangement—parties, particularly if they are a listed company, often voluntarily commission an expert's report;
- (f) compulsory acquisition or buy-out (s663B, 664C and 665B)
- (g) acquisition approved by holders (item 7 of s611 and PS 74);
- (h) selective capital reduction under s256B and 256C (Practice Note 29 *Selective capital reductions* [PN 29.27]);

- (i) prospectus or Product Disclosure Statement—particularly as a way for the issuer to show it has reasonable grounds for prospective financial information (Policy Statement 170 *Prospective financial information* [PS 170.34]);
- (j) related-party transaction approved under Pt 2E;
- (k) joint bid—the bidders must use their best endeavours to have the target commission an expert’s report on the bid (Media Release [MR 01/295] ‘ASIC clarifies its policy on joint bids’);
- (l) transaction with persons in a position of influence (ASX Listing Rule 10.10.2);
- (m) demutualisation of a financial institution (Schedule 4 clause 29); and
- (n) buy-back—particularly where the consideration is not cash (Policy Statement 110 *Share buy-backs* [110.46]).

Contents

What this policy proposal is about 3

Our policy proposals..... 6

A Independence 6

Explanation13

B Expert’s role.....19

Explanation23

C Quality and content.....27

Explanation33

D Regulatory action.....38

Explanation40

Regulatory and financial impact41

Development of policy proposal42

Key terms44

What will happen next?.....45

Our policy proposals

A Independence

Policy proposal	Your feedback
<p>Licensees must manage conflicts</p> <p>A1 Under the CLERP 9 Act, experts that have an Australian financial services (AFS) licence are required to have adequate arrangements for the management of conflicts of interest that may arise in relation to giving an expert's report: s912A(1)(aa).</p> <p>Note 1: The conflicts management obligation s912A(1)(aa) has effect from 1 January 2005.</p> <p>Note 2: These proposals are specific to experts. Our Policy Statement 181 <i>Licensing: managing conflicts of interest</i> (Conflicts PS) discusses our general approach to compliance with s912A(1)(aa). Proposals about conflicts management in this PPP should be read with the Conflicts PS. Some issues in <i>Managing conflicts of interest: An ASIC guide for research report providers</i> (November 2004) might also be useful to experts.</p> <p>Reinforces existing requirements</p> <p>A2 The requirement to manage conflicts of interest reinforces existing requirements in the Act, case law and our policy on takeovers and fundraising. Under existing requirements experts must be independent of:</p> <ul style="list-style-type: none"> (a) the client; and (b) an interested party. <p>Note 1: We list examples of existing requirements that the expert is independent in the Explanation.</p>	<p>A1Q1 Do any practical difficulties arise for experts from this conflicts management obligation? Please specify.</p>

Policy proposal

Note 2: For these purposes, an “interested party” is a person that has an interest in the outcome of the transaction different from the general body of holders e.g. any person with a substantial interest in the client or a target; if the client is the bidder, the target; an associate of the client; a promoter in a fundraising; or another party to a reconstruction.

A3 Section 912A(1)(aa) does not change existing independence requirements. But having adequate conflicts management arrangements will help the expert to comply with independence requirements. Section 912A(1)(aa) gives new emphasis to the expert’s internal arrangements.

A4 At the same time that conflicts management reinforces independence requirements, these existing requirements will inform the design, implementation and maintenance of conflicts management arrangements specific to experts.

Note: What a licensee needs to do to comply with the conflicts management obligation varies according to the nature of the financial services business.

A5 Section 912A(1)(aa) applies to an expert commissioned to give its opinion in relation to financial products, whether or not the expert holds out that it is independent and whether or not the client commissions the expert’s report voluntarily.

Arrangements

A6 An expert that holds an AFS licence must have in place arrangements (i.e. measures, processes and procedures) to avoid, control and disclose conflicts. The expert must document these policies and procedures and implement them. We expect that the expert will keep records showing what it has done to monitor compliance.

Your feedback

A5Q1 Should the expert’s conflicts management arrangements reflect existing independence requirements where the report is not labelled ‘independent’? If not, what arrangements should apply?

Avoiding conflicts

A7 Some conflicts of interest cannot be adequately addressed by controls and disclosure. The expert's internal policies and procedures should give specific guidance on conflicts where it must decline to act. For example, the policies should specify what relationships between the client and the expert would preclude it from acting, such as where an officer of or a partner in the expert involved in developing experts' reports is an officer of the client or an interested party.

Note: We list examples of conflicts where the expert must decline to act in the Explanation.

Auditor

A8 We currently propose to retain our policy that an expert is not precluded from providing a report merely because it acts (or has acted) as auditor of the client, a company the subject of the report or an interested party.

Disclosing conflicts

A9 Even where the expert has a conflict that does not preclude it from acting, it should ensure that investors are informed about the conflict through prominent, specific and meaningful disclosure in the expert's report: see also s648A(3) and 711(3) and (4).

A7Q1 In practice, do experts ever decline to act because of other work with the client? In what circumstances?

A7Q2 Should we say that as 'good practice' the expert should have an internal policy on what volume or value of other work for the client may compromise its independence?

A8Q1 Is an expert that also acts as auditor independent?

A8Q2 Is there a concern if the expert audits:

- (a) a target, because it might be replaced if the bid is successful?
- (b) both the bidder and target?

A8Q3 Is there a risk that an expert will be constrained from taking a different view on a financial report from that it took as auditor?

A9Q1 Should an expert disclose if the financial or legal adviser that referred it to a client has frequently referred it to clients in the past?

A10 We are concerned that some experts' reports do not currently contain adequate fees disclosure. It is not enough for the expert to say it is being paid a 'normal professional rate'.

Controlling conflicts

A11 The expert's internal policies and procedures should also address e.g.:

- (a) communications and dealings with the client during the expert's engagement and preparation of the report; and
- (b) remuneration; and
- (c) supervising preparation of reports.

Communications with client

A12 An internal policy about communications and dealings with the client e.g.:

- (a) should prohibit the expert's staff from discussing the merits of the transaction or giving any preliminary indication of its views to the client before it is engaged;
- (b) should require that under the terms of the expert's engagement the client must disclose the report to investors (if the transaction proceeds). This is consistent with s648A(1);
- (c) should prohibit staff from discussing choice of methodology with the client ([PN 42.22]);
- (d) should prohibit staff from accepting from the client its analysis of the facts of the transaction ([PN 43.13]), but could allow them to interrogate the client's management for the purpose of their own analysis. The expert would need to set the agenda and keep comprehensive notes of the discussions;
- (e) could allow staff to give to the client for checking the part of the expert's report

A11Q1 Should we require that there is a separate organisational unit or person (e.g. in the compliance area) that monitors compliance with internal policies?

A12Q1 Should the expert ever discuss with the client the substance of the expert's report (apart from factual inquiry), analysis or the methodology used? In what circumstances?

A12Q2 At what stage should the draft report be at the time it is sent to the client?

A12Q3 In practice, do experts give to the client for fact checking:

- (a) that part of the report containing factual discussion only;
- (b) the whole report, but with conclusions and important figures deleted; or
- (c) the whole report?

Which option is preferable?
Give reasons.

A13Q1 Should staff working in corporate finance or advisory supervise those working on expert's reports?

A13Q2 Should information barriers between the expert business and other parts of the firm

setting out the facts (without communicating the expert's valuation, opinions and recommendations):
Phosphate Co-op Co of Australia Ltd v Shears (No 3) (1988) 14 ACLR 323, 337 (Pivot case). The report should say that the expert gave the draft to the client, the purpose of doing so, and what changes were made as a result; and

- (f) should require the expert to give the report to the client even if the client requests that it does not do so (unless the transaction is discontinued).

Approval of report

A13 Under the expert's internal policies, reports should be reviewed and approved before publication by an experienced supervisor or by an internal review committee to maintain quality and integrity. A written record should be kept of the review and approval of each expert's report. The expert should consider approval or reporting arrangements to ensure independence.

“Independence” a restricted word

A14 The expert might breach s923A if it holds itself out as independent and it either:

- (a) is paid a success-based fee (see s923A(2)(a)); or
- (b) has a conflict of interest arising from its relationship with an issuer that might reasonably be expected to influence the expert in giving the expert's report (see s923A(2)(e)).

Misleading conduct

A15 Even without the prohibition in s923A, where the expert or the client holds the expert out to be 'independent' and the expert is not in fact independent, this constitutes misleading

have a role in our policy? Even if the expert had information barriers, it would still have to avoid the conflicts in proposal A7 and disclose its interests.

A13Q3 Is it practical to apply information barriers between the expert business and e.g. corporate finance or advisory? Would barriers disrupt the structure of an expert's business? Would barriers prevent staff working on experts' reports gaining further experience of transactions?

or deceptive conduct. It is also misleading for an expert to give an opinion it does not hold.

Compulsory acquisition

A16 A 90% holder may increase the consideration for a compulsory acquisition after the expert has given its report and before the 90% holder has lodged its compulsory acquisition notice: s667A(1) and 664C. The expert would then be required to amend its report in light of the increased consideration.

A17 The expert's report must disclose the original consideration and opinion and summarise the changes from the original report.

Industry or specialist experts

A18 We propose to retain our policy that where a client or expert commissions an industry or specialist expert to report on a particular aspect of a transaction, the industry expert must be independent from the client or an interested party: [PN 42.21] and [PN 43.26].

A19 It would be preferable for the expert to commission the industry expert's report, so that the industry expert is seen to be acting independently of the client: [PN 42.21].

Who commissions the report?

A20 Directors of the client who are not associated with the transaction or with an interested party should commission the expert's report: [PS 74.11(a)]. For example, in a fundraising, a director who is a promoter should not commission the report.

A16Q1 Does s667A allow this process?

A16Q2 Do any 90% holders currently improve consideration once they have received the expert's report?

A16Q3 Is there a risk that 90% holders will set consideration below fair value because they can always improve it if the expert's report is adverse?

A18Q1 In the exceptional case that the relevant industry or field is very small, is it reasonable that an industry expert must be independent? Does the expert's specialist knowledge outweigh the risk that the expert's opinion will be compromised?

A19Q1 Should we change this policy? The expert does not necessarily lack independence because it was appointed by the client.

Client's responsibility

A21 If the client commissions two or more reports, it must give a copy of each report to investors, whether or not the requirement in e.g. s648A(1) applies and whether or not the reports are from the same expert: *Pivot* case p339.

A22 The directors of the client may not take comfort in an expert's report without critically analysing it. The directors must:

- (a) take steps to satisfy themselves of the validity of the information given to the expert;
- (b) consider whether assumptions are reasonable, in the light of the directors' overall knowledge of the business;
- (c) undertake reasonableness checks of the values given by the expert.

Explanation

1 The Corporations Act requires an expert's report to protect investors by giving them an *independent* professional opinion.

Note: Language also used by the courts, our policies and commentators includes: 'impartial judgment'; 'credible and reliable'; 'disinterested'; 'objective'; 'unbiased'; 'genuine expression of opinion'; and, **negatively**, 'conflict of interest', 'compromised' and 'acting in a partisan capacity'.

2 The Corporations Act affords investors this protection where particular risks are present, where certain parties may dominate investors because of associations, control or unequal bargaining power. For example, where the bidder has voting power of at least 30% of the target an expert's report is required because:

- (a) the bidder may exercise control over the target;
- (b) the target may not pursue the interests of its holders to the extent it would if there was no such control; and
- (c) it is less likely that a better rival bid will emerge.

3 Brooking J in the *Pivot* case (1988) 14 ACLR 323, 339 said:

'These reports are either required by the [Corporations Act] or provided by analogy with those requirements. In either case, they are supposed to be for the protection of individuals who are being invited to enter into some kind of transaction. Unless high standards are observed..., there is a danger that systems established for the protection of the investing public will, in fact, operate to their detriment through reliance placed on these reports and on the reputations of those who furnish them.'

4 Lack of independence reduces the quality of the expert's report: independence and the quality of experts' reports are closely linked. The expert must not only be independent, but be seen to be independent. Lack of independence, or a perceived lack, reduces the information value of the report: an investor might discount the expert's opinion. See e.g. the purpose behind the takeover provisions that the acquisition of control takes place in an efficient competitive and *informed* market: s602(a).

Licensees must manage conflicts

5 A conflict of interest is where an interest of the investors receiving the report diverges from that of the expert. This includes actual, apparent and potential conflicts. For example, the expert's

interest in generating fees from ' reports that might be commissioned by the client or other potential clients in the future may diverge from investors' interest in an independent opinion.

6 Generally, an expert that carries on a business of giving 'expert's reports must hold an AFS licence to provide financial services to retail clients because an expert's report constitutes financial product advice: s911A(1). The expert's report is a recommendation, statement of opinion or report that is intended to influence investors and the client in making a decision in relation to a financial product, or could reasonably be regarded as intended to influence: s766B(1). The licence obligation applies to all experts that give opinions about financial products.

7 The conflicts management obligation in s912A(1)(aa) applies irrespective of whether:

- (a) the expert says that it is independent of the client;
- (b) a requirement that the expert is not an associate of the client applies (e.g. s648A); or
- (c) the client commissions the expert's report voluntarily.

8 It is appropriate that the conflicts management requirement applies to an expert whether or not it holds itself out as independent. Where any report by an expert is given to an investor, they are entitled to expect that the expert's professional judgment is not significantly compromised. Reports that are not labelled 'independent' are usually very similar in presentation and context to independent reports. It is often unclear from reading the report why the expert is not independent.

9 (Another example of a licensing obligation that applies to experts is the Financial Services Guide requirement: Pt 7.7. Where an expert's report is included in e.g. a prospectus or PDS, the expert's FSG may be included as a separate and clearly identifiable part of the expert's report: Class Order [CO 04/1572].)

Exempt document

10 Providing an 'exempt document' like a prospectus or bidder's statement does not constitute financial product advice: s766B(1) and s766B(1A). We have also exempted issuers of certain documents from the requirement to hold a licence: see [CO 03/606] and [IR 03/20].

11 An expert's report is not an exempt document. Even if an expert's report is included in an exempt document, giving an expert's report constitutes financial product advice because:

- (a) the expert is an 'outside expert': s766B(1B) and s766B(9);
- (b) our relief in [CO 03/606] does not apply to the expert because it applies only to the person who prepares the prospectus or bidder's statement itself (the issuer or bidder); and
- (c) at the time it is given to the client, it is not included in an exempt document.

When is no licence required?

12 An expert's report on matters other than financial products is covered by an exemption where:

- (a) the advice is included in a document issued in connection with a takeover bid or an offer of a financial product; and
- (b) the advice is an opinion on matters other than financial products: reg 7.6.01(u).

13 A note to the regulation gives a geologist's report as an example. An accountant will need to satisfy itself whether it needs a licence to give an independent or investigating accountant's report. Whether the accountant needs a licence may depend on the scope and nature of particular reports. There is a range of different reports. For example, a report that gives an opinion in relation to pro forma financial statements is more likely to attract licensing. It goes more directly to value.

14 An exempt expert's report must say that the person is not operating under a licence. It must disclose remuneration, interests and relationships: reg 7.6.01(u)(iii) and (iv).

What is our regulatory approach?

15 Once we have finalised our policy proposals on expert's conflicts management, we would take them into account (along with Policy Statement 181 *Licensing: managing conflicts of interest*) in administering the Act, including considering whether to take action in relation to any particular expert: see proposal D5.

Reinforces existing requirements

Associate

16 There are already absolute prohibitions in the Act against an expert acting where it is an 'associate' of the client e.g. in a takeover, scheme or compulsory acquisition: s12, s648A(2),

Schedule 8 to the Corporations Regulations clause 8303 and s667B(1).

Unbiased

17 Where an expert is not an associate of the client, an expert's report must still be unbiased. 'Where experts claim independence, they must be genuinely so': Santow J in *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77.

ASIC nominated expert

18 A person who proposes to get an expert's report in a compulsory acquisition or buy-out must request that we nominate the expert: s667AA(1). This is an express provision aimed at independence. We discuss our nomination of experts in Policy Statement 159 *Takeovers: discretionary powers* [PS 159.107]. In nominating, we will ask if the expert has a conflict: [PS 159.111].

Avoiding conflicts

19 The expert's internal policy on when it will decline to act should reflect existing requirements in the Act, case law and ASIC policy. For example, the expert should not act where:

- (a) it is a substantial investor in or creditor of the client or has any other significant financial interest in the relevant transaction. Nor should the expert act if an officer of or partner in the expert has a significant financial interest;
- (b) an officer or a partner involved in developing experts' reports is an officer of the client or an interested party; or
- (c) it has participated in strategic planning work for the client (e.g. by advising on possible takeovers).

20 In *Re Shine Fisheries Ltd* (1994) 12 ACSR 627, 632 Master Adams suggested an expert is not independent if it is also on a retainer to give financial advice, including strategic takeover advice.

21 The expert's internal policy should also prohibit staff working on the report from cross-selling other services of the expert while preparing the report. Staff should not be focused on other work that the expert might undertake for the client.

Auditor

22 Our existing policy is based on the comments of Dowsett J in *Hillhouse v Gold Copper Explorations NL (No 2)* (1987) 13 ACLR 208, 211 that he 'would not be concerned by the fact that

the firm might act as auditors, auditors themselves being required to be independent'.

23 But there is an argument that a conflict might exist where the target's expert is auditor of the target. If the bid is successful, the bidder may replace the expert as auditor.

24 United States SEC Rule 210.2-01 paragraph c(4) says that in certain circumstances an auditor is not independent where:

- (a) it provides a fairness opinion; and
- (b) it is reasonably likely that the opinion would be material to the financial statements or will be audited by the accountant.

Disclosing conflicts

25 Conflicts management 'will include ensuring that there is adequate disclosure of conflicts to investors, who can then consider their impact before making investment decisions': Commentary to the exposure draft CLERP 9 Bill para 585.

26 In a takeover bid or compulsory acquisition, the expert must disclose details of:

- (a) any business and professional relationship with the bidder or target;
- (b) any financial or other interest capable of affecting the expert's ability to give an unbiased opinion; and
- (c) any fee or benefit (whether direct or indirect) in connection with the report (s648A(3) and 667B(2)).

27 A prospectus or a scrip bidder's statement must disclose:

- (a) any interests the expert has in the company; and
- (b) fees and benefits given or agreed for the expert's services (s711(1)–(4)).

28 Practice Note 43 sets the two previous years as an indicative minimum period for disclosure of details of any relationship with a bidder, target or interested party: see [PN 43.23] and s711(2). Two years is a useful guide for experts in complying with s912A(1)(aa).

Controlling conflicts

29 An expert's internal policies and procedures should address issues already discussed by authorities and ASIC policy on commissioning and preparing an expert's report: see [PN 42.6] – [PN 42.15], [PN 42.20] – [PN 42.26] and [PS 75.16].

30 An expert's internal policies on remuneration should say that it must not accept a success fee (a fee contingent on the completion or frustration of the transaction): [PS 75.16(e)].

Misleading conduct

31 In *Re Shine Fisheries Ltd* (1994) 12 ACSR 627, 632 Master Adams said that the experts:

‘could not fairly be described as “independent” and in my view it was misleading of them and of the board to so hold them out to the shareholders’.

32 In *Reiffel v ACN 075 839 226 Ltd* (2003) 45 ACSR 67, 93 the expert, having chosen to express an opinion, had an obligation not to mislead in doing so. It did not hold the opinions it expressed. It should not have given an unqualified negative assurance about a forecast of a promoter where it disagreed with the promoter's methodology and adopted a different one.

33 It would be misleading for an expert to say or imply that a valuation was its own when the client has had significant influence over the valuation: Media Release [MR 01/219] ‘ASIC issues final stop order on biotech float’.

Industry or specialist experts

34 An expert can use an industry expert's report commissioned by the client if the expert is satisfied with the standard and independence of the report: *Re Matine Ltd* (1998) 28 ACSR 268, 288.

Client's responsibility

35 In the *Report of the investigation into Burns Philp & Co Ltd* (1998) we said that directors of the client should critically assess the assumptions behind an expert's valuation before taking comfort in it. This related to independent valuations of intangible assets (tradenames). But the client must give the expert's report to investors even if it disagrees with it or commissions another: e.g. s648A(1). Section 648A(1) requires that if the bidder or target obtains 2 or more reports for the purposes of s636(1)(h)(iii) or 640(1) the bidder's or target's statement must be accompanied by each report.

B Expert's role

Policy proposal	Your feedback
<p>Fundamental role</p> <p>B1 The expert's role is to help investors to make the commercial decision facing them in the transaction.</p> <p>B2 The fundamental question facing investors in all transactions is 'will they be better off if the transaction proceeds or if they participate'? However, the expert's opinion must be put in terms of the relevant legal test for the expert's role, e.g. whether a takeover bid is 'fair and reasonable' or a scheme is in the 'best interests' of members.</p> <p>Note: The expert's role under s667A(1) and 667C is distinct from its role in other contexts: <i>Capricorn Diamonds Investments Pty Ltd v Catto</i> (2002) 41 ACSR 376, 438. We consider compulsory acquisition separately below.</p> <p>Types of transactions</p> <p>B3 For example, in a merger, whether by scrip takeover bid or scheme of arrangement, the main focus is a comparison of the value of the target securities and the scrip consideration.</p> <p>Note: We discuss types of transactions further in the Explanation.</p> <p>Expertise</p> <p>B4 An expert must ensure that staff preparing and supervising the expert's report have sufficient skill, knowledge and experience to perform the expert's role.</p>	<p>B2Q1 Is the language 'fair and reasonable' useful in our policy on the expert's role in an acquisition approved by holders: item 7 of s611, PS 74.9(d) and PS 74.20?</p> <p>B2Q2 Is there a distinction in practice between the fair and reasonable test and the best interests test?</p> <p>B3Q1 Are there other common or substantial focuses for experts in particular types of transactions that we need to note?</p>

Policy proposal	Your feedback
<p>Qualitative factors</p> <p>B5 In giving its opinion, the expert must clearly and prominently distinguish:</p> <ul style="list-style-type: none"> (a) its valuation; and (b) other factors or implications that it takes into account (often qualitative). <p>B6 This issue is related to that of a ‘not fair but reasonable’ opinion. This is an opinion in a takeover bid that although the offer price is less than the value of the securities, after considering other significant factors, holders should accept the offer in the absence of any higher bid before the close of the offer: see [PS 75.29]. Under this policy, ‘fair’ and ‘reasonable’ are separate concepts. At this stage, we are not proposing to change our policy. It is an established feature of the Australian takeovers landscape.</p> <p>B7 A not fair but reasonable opinion is not a way for an expert to avoid making a difficult decision on its opinion. The main concern of holders will usually be whether the offer price is fair. We expect such opinions will be exceptional.</p> <p>Recommendation</p> <p>B8 We are proposing to retain our policy that an expert should seriously consider saying whether or not it is in the interests of shareholders to accept, in the absence of a better offer: [PS 75.24].</p> <p>Whose interests are relevant?</p> <p>B9 Experts must address the interests of different holders in different transactions e.g.:</p> <ul style="list-style-type: none"> (a) in a scheme of arrangement the expert must address the interests of ‘members who are party to and bound to give up 	<p>B8Q1 Should we omit this policy?</p> <p>B8Q2 Or should an expert usually make a recommendation and explain if it does not?</p> <p>B9Q1 In a scheme of arrangement, should the expert separately consider the interests of each class under the scheme?</p> <p>B9Q2 Instead in a scheme should the expert balance the interests</p>

Policy proposal	Your feedback
<p>rights under the scheme', not those of a member who is the other party to the scheme (<i>Re Hudson Conway</i> (2000) 33 ACSR 657, 666); and</p> <p>(b) in an acquisition approved by holders, the interests are those of holders who are not involved in the acquisition (item 7(a) of s611).</p>	<p>of different classes? Is this inconsistent with separate class meetings?</p>
<p>Other proposals</p> <p>B10 The expert should assess the transaction against rival offers or other proposals for the conduct of the business of the company. The offer or business proposal must not be merely speculative. Another proposal for the business must be capable of implementation.</p>	<p>B10Q1 Must the board have seriously considered another business proposal?</p> <p>B10Q2 Is it appropriate for the expert to generate an alternative proposal?</p>
<p>Compulsory acquisition: fair value</p> <p>B11 In a compulsory acquisition, the expert's role is to give its opinion on whether the terms proposed in the compulsory acquisition notice give a 'fair value' for the securities under s667C.</p>	<p>B11Q1 Should we say: the current balance of court authorities is that the expert should exclude 'special value' from fair value?</p>
<p>No minority discount</p> <p>B12 The expert must not apply any minority discount. This is because the expert must:</p> <p>(a) value the company as a whole (s667C(1)(a) and <i>Teh v Ramsay Centauri Pty Ltd</i> (2002) 42 ACSR 354, 359); and</p> <p>(b) not apply 'any discount for particular securities in that class': s667C(1)(c).</p> <p>B13 A minority discount is the difference between:</p> <p>(a) the portfolio value (the value of voting shares that do not deliver control); and</p>	

Policy proposal	Your feedback
<p>(b) the value of the company as a whole divided by the number of voting shares.</p> <p>Particular parcel</p> <p>B14 The expert must not take into account the tactical value of a particular parcel that stands between an acquirer and 100% ownership: s667(1)(c).</p> <p>Forcible taking</p> <p>B15 The expert must not include in fair value a premium for forcible taking (compensation for divestment): e.g. <i>Capricorn Diamonds v Investments Pty Ltd v Catto</i> (2002) 41 ACSR 376, 431.</p> <p>Benefit to other party</p> <p>B16 An expert should take into account a benefit under the transaction to a party with an interest different from the general body of holders in giving a fair and reasonable or best interests opinion: <i>Re Hudson Conway Ltd</i> (2000) 33 ACSR 657, 666.</p>	

Explanation

Fundamental role

1 Experts' reports should:

- (a) be useful to the audience of the report; and
- (b) promote understanding by investors of the transaction, its impact on the value of the investors' securities and the commercial decision facing investors.

2 Experts 'must ensure that their reports deal adequately with the kind of concerns that could reasonably be anticipated from those affected' by the transaction: Santow J in *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77. In *AuIron Energy Ltd* [2003] ATP 31 at [59] the Panel said that 'the role of the expert is to assist the shareholders with the choice they have to make'.

3 In a takeover bid, the expert must express its opinion in terms of the 'fair and reasonable' test even where the report is provided voluntarily e.g. where s640 does not apply. Voluntary reports are provided by analogy with requirements under the Act. The test has a well-established usage and to depart from it, merely because the report is not mandatory, is potentially misleading.

Types of transactions

4 While the expert must express its opinion in terms of the legal test, the purpose of this discussion is to illustrate that the expert must focus on the questions facing investors in the transaction and not mechanically apply the test. In general, the expert's main focus in different types of transactions is:

- (a) in a **cash takeover bid**, a comparison of the cash consideration and the value of the bid class securities: would the holder be better off with the cash or the shares? ([PS 75.26]);
- (b) in a **merger**, a comparison of the value of the securities being acquired with the value of securities offered. This applies whether the merger is effected by scrip takeover bid, merger scheme of arrangement or a 'trust scheme' under item 7 of s611 (see *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143). Similar questions to those in a merger might also be raised for an expert where control changes because shares are issued for

an acquisition: see item 7 and para 4(d). Where the bidder would be likely to control the target following the transaction, the expert should value the scrip consideration on a notionally consolidated basis: it should value the securities as if the bidder already owned the target;

- (c) in a **demerger** by scheme of arrangement and equal capital reduction where there is a pro rata issue of shares in the new company to holders, the likely advantages and disadvantages if the demerger proceeds compared to if it does not. The holder's economic interest in the underlying businesses does not change. There is no change of control and no selective treatment of different holders. However, the expert might need to value the demerged businesses to test whether the sum of the parts is greater than the whole;
- (d) where holders are asked to **approve an acquisition of securities** under item 7 of s611, a comparison of the value of the securities if the transaction proceeds with that if it does not: *AuIron Energy Ltd* [2003] ATP 31 at [59]. The expert should also consider likely advantages and disadvantages: [PS 74.21].

Where the holders are asked to approve a new issue of securities, the expert must value any business acquired by the company in return for the securities. If the value of the business is at a discount to the value of the securities, holdings will be economically diluted by the transaction.

In a transfer of securities, the expert must quantify any premium for control being paid by the acquirer to the seller: [PS 74.23]; and

- (e) in a **selective reduction of capital**, balancing the interests of expropriated and continuing holders. This will be easiest where the consideration is close to the value of the securities to be cancelled. This balance is because the reduction must be fair and reasonable to shareholders *as a whole*: s256B(1)(a). The expert should consider all the circumstances of the transaction, such as a concurrent sale of a business by the company: *Re Rancoo Ltd* (1995) 17 ACSR 206.

Expertise

5 'Expert' means a person whose profession or reputation gives authority to a statement: s9. This implies that the expert's staff preparing the report must have sufficient skill, knowledge and

experience. Profession and reputation are built on these. In addition, experts as licensees must e.g. have sufficient human resources and maintain the competence to prepare the expert's report: s912A(1)(d) and (e). In 2001 we took licensing action because an expert did not have the expertise to complete its task satisfactorily: [MR 01/421] "ASIC clips Falconer's wings".

Qualitative factors

6 A not fair but reasonable opinion:

- (a) is an established feature of the takeovers landscape in Australia. Experts and many investors are familiar with the concepts, even though we are aware of criticisms by commentators, based largely on the awkwardness of splitting the compound phrase "fair and reasonable";
- (b) gives investors better information, because it immediately and prominently flags to investors that the expert's opinion is equivocal; or
- (c) gives a structure for the expert to:
 - (i) clearly distinguish between value issues and qualitative issues. Investors may discount qualitative judgements of the expert; and
 - (ii) accommodate unusual circumstances.

7 An expert who gives an opinion that the offer is not fair but reasonable must explain very clearly what it means by this.

Recommendation

8 Arguably, a not fair but reasonable opinion as defined in [PS 75.29] amounts to a recommendation to accept in the absence of a higher bid.

9 A recommendation might be problematic because the individual circumstances of holders differ. But we already require the expert to warn holders about this: [PS 75.30].

Other proposals

10 The expert should consider other proposals only if the transaction prevents adoption of the proposals: *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 92.

Compulsory acquisition: fair value

11 In a compulsory acquisition, the Act prescribes how the expert must value the securities: s667C(1). The main debate on the role of the expert in compulsory acquisition has been whether fair value should exclude 'special value'.¹

12 In practice, whether special value should be excluded is often not a critical issue because it is not material once it has been allocated to the particular class of security and has then been allocated pro rata to each security: s667C(1)(b) and (c).

¹ One line of court authorities states that because s667C(1)(c) precludes 'a premium...for particular securities' and the legislative purpose was to discourage greenmailing, the expert must exclude special value: e.g. *Capricorn Diamonds v Investments Pty Ltd v Catto* (2002) 41 ACSR 376, 396 and *Pauls Ltd v Dwyer* (2003) 43 ACSR 413. The alternative view is that special value is inherent in 'the value of the company as a whole' (s667C(1)(a)): e.g. *Re Goodyear Aust Ltd; Kelly-Springfield v Green* (2002) 20 ACLC 983.

C Quality and content

Policy proposal	Your feedback
<p>Large or technical reports <i>Clear, concise and effective</i></p> <p>C1 The expert's report must be worded and presented in a clear, concise and effective manner: s249L(3); 715A; 1013C(3); and <i>Australian Co-operative Foods Ltd</i> (2001) 38 ACSR 71, 77. The expert's report must not contain extraneous information: information that does not relate directly to the expert's opinion.</p> <p>C2 The 'clear, concise and effective' requirement addresses presentation of disclosure documents, e.g. the structure, length, language and readability. The expert should focus on the needs of different readers: retail investors, wholesale investors and advisers. The requirement does not limit the information that the expert must disclose to support its opinion.</p> <p><i>Incorporation by reference</i></p> <p>C3 The client may incorporate a more technical and complex expert's report (or a part of it) by reference into a prospectus or bidder's statement: s712 and 636(1)(g). We may give case-by-case relief similar to s712 for other transactions.</p> <p>C4 The client must describe the expert's report in the prospectus under s712(2). It must identify the expert and explain the scope and purpose of the report. The client should also state the conclusions, methodologies and the major assumptions: <i>Carr Boyd Minerals Ltd v Queen</i> (1987) 7 ACLC 1029, 1035.</p>	

Policy proposal	Your feedback
<p><i>Client's information</i></p> <p>C5 The expert should not allow its report to be used as the vehicle for disclosure of new information that the client should have disclosed under continuous disclosure or in the bidder's statement or prospectus itself e.g. new information about the financial performance of the client.</p> <p>Valuation methodologies</p> <p><i>Basis of choice</i></p> <p>C6 The expert must have a tenable basis for choosing its valuation methodologies: <i>Re Matine</i> (1998) 28 ACSR 268, 290. An inappropriate choice might be misleading: <i>Re EPHS Ltd</i> [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: <i>Duke Group Ltd v Pilmer</i> (1999) 31 ACSR 213.</p> <p><i>Disclosure</i></p> <p>C7 The expert must justify its choice of methodology. The expert must disclose methodologies and the basis of a valuation in sufficient detail for the reader to judge the reliability of the report: <i>Re BNQ Sugar Pty Ltd</i> (1994) 12 ACSR 695, 702. Where we take regulatory action over valuation methodologies, it is often because of inadequate disclosure.</p> <p>C8 If the expert rejects a valuation methodology in our indicative list of methodologies in [PN 43.39], it should explain why.</p> <p><i>Different methodologies</i></p> <p>C9 The expert should use a range of different valuation methodologies, unless this is inappropriate for the circumstances. This reduces</p>	<p>C9Q1 Should the expert analyse the market price of quoted securities over a period of at</p>

Policy proposal

the risk that the expert's opinion is distorted by its choice of methodology. The expert's report should analyse the market price of quoted securities. The expert should discuss the implications for its valuation where the market value differs materially from that derived by other methods: [PN 43.44].

Additional methodologies

C10 We propose to add to the indicative list of valuation methods in [PN 43.39]:

- (a) for options over unissued shares, an option pricing model like Black-Scholes or binomial. Experts may derive useful guidance in valuing options from accounting standards in the directors' remuneration context; and
- (b) for hybrid securities, market price for quoted securities; and discounted cashflow method for the debt component and an option pricing model for the option component.

Assumptions

C11 The expert must clearly disclose and justify all its assumptions.

C12 As with all statements in the expert's report, there must be reasonable or rational grounds for the assumptions, or the opinion will be misleading. An inappropriate assumption might mean the expert did not take sufficient care and skill: *Duke Group Ltd v Pilmer* (1999) 31 ACSR 213.

Statements must be supported

C13 We might take regulatory action if the expert makes a material statement that is not supported by checks, inquiries and analysis: [PN 43.57].

Your feedback

least the last 6 months: see s667C(2)?

C10Q1 Are there other common methods or securities to which we should refer?

Policy proposal	Your feedback
<p>Control premium</p> <p>C14 The expert should disclose whether or not it separately attributes a value to a control premium, and should quantify any premium. This would only be required where the expert is valuing securities rather than the company as a whole. It would be where the expert's starting point is a portfolio value.</p> <p>Range of values</p> <p>C15 We propose to maintain our policy that the expert should usually give a range of values of securities. The value of securities is often uncertain or volatile. An expert who gives a single point may imply spurious accuracy: PS 75.34, PN 43.38 and [PS 170.79].</p> <p>C16 The expert should give a most probable point in a range if this is feasible: [PN 43.38].</p> <p>C17 It is critical that the expert gives as narrow a range of values as possible. An expert's report becomes meaningless if the range is too wide: [PN 43.38] and [PS 75.34].</p> <p>C18 If the expert cannot justify using a narrow range because of uncertainty, the expert's report must prominently explain:</p> <ul style="list-style-type: none"> (a) what factors create this uncertainty; and (b) how the expert is able to give its opinion in light of this uncertainty. 	<p>C14Q1 Is there a type of transaction or valuation method where it is inappropriate to separately attribute a value to a control premium e.g. discounted cash flow?</p> <p>C15Q1 If the value of consideration is at the lower end of a range of fair values, should the expert make a prominent statement to this effect in the 'summary' or 'opinion' section of its report?</p> <p>C15Q1 Should the expert instead give a single fair value? Could experts come under more pressure from a client in setting this single value?</p> <p>C16Q1 Is one point in a range a more likely value than any other point? Is a most probable value useful for investors? Does a single point risk being a theoretical value only?</p> <p>C16Q2 Is the most probable value usually the mid-point of the range?</p> <p>C17Q1 Should we give further guidance on what constitutes a range that is too wide? What range is reasonable and what factors are relevant?</p>

Policy proposal	Your feedback
<p>Prospective financial information</p> <p>C19 The expert should carry out sufficient inquiries to establish reasonable grounds for believing that any prospective financial information used in the expert's report is prepared on a reasonable basis. Our guidance about the quality of experts' reports applies equally to prospective financial information in a report: [PN 43.47]. Further guidance in Policy Statement 170 <i>Prospective Financial Information</i> applies to experts.</p> <p>Confidential information</p> <p>C20 An expert must not omit material information from an expert's report merely because it is confidential. But the expert may adequately support its opinion by careful disclosure without revealing confidential information: ASIC Policy Statement 170 <i>Prospective financial information</i> [PS 170.67].</p> <p>C21 We propose to omit our policy of relief for the non-publication of parts of the expert's report that contain confidential information that is not material: see [PS 75.23]. This policy is rarely used. It is onerous for us to determine that information is not material where the expert has included the information in its report.</p> <p>New circumstances</p> <p>C22 An expert must give the client a supplementary expert's report as soon as practicable if it becomes aware that there has been a significant change affecting the information in the report: s670C(2) and (3) and 729–730, <i>ASIC v Solution 6 Holdings Ltd</i> (1999) 30 ACSR 605 and <i>Duke Group Ltd v Pilmer</i> (1999) 31 ACSR 213, 272–3.</p>	<p>C21Q1 If we omit this policy, is there a risk that the client will pressure the expert to omit information that the client argues is not material?</p>

Policy proposal	Your feedback
<p><i>Client's responsibility</i></p> <p>C23 In a takeover bid, a bidder or target must lodge a supplementary statement attaching the supplementary report. The bidder or target should also send the supplementary statement to holders. For a prospectus, the issuer should lodge a supplementary or replacement prospectus: s719(1). In e.g. a scheme of arrangement, the client should send the supplementary report to holders prior to the meeting.</p> <p>C24 The client should send the supplementary report to investors even if they would receive it close to the meeting or end of the bid.</p> <p>Directors' report</p> <p>C25 It is strongly preferable for the company to give holders an independent expert's report rather than an independent directors' report in an acquisition approved under item 7 of s611: see [PS 74.11].</p> <p>C26 We will look closely at a directors' report. Our experience is that directors' reports often do not meet the standard expected of an expert's report. This means that the company will not meet the disclosure requirement in item 7(b).</p>	<p>C25Q1 Should we require an expert's report in all cases?</p>

Explanation

1 Experts' reports must be:

- (a) relevant and complete—experts' reports should give sufficient information for investors to make an informed decision (e.g. s602(a) and (b)(iii); *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77); and
- (b) worded and presented in a clear, concise and effective manner e.g.:
 - (i) highlight important information; and
 - (ii) have regard to the communication needs of investors (both retail and wholesale) and their advisers.

See the 'Good Disclosure Principles' in Policy Statement 168 *Disclosure: Product Disclosure Statements* [PS 168.44], [PS 168.65] and [PS 168.69].

Large or technical reports

Clear, concise and effective

2 Currently we are concerned that the inclusion of extraneous information in and presentation of some experts' reports undermines their usefulness, readability and clarity.

3 Santow J in *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77 said that experts' reports must be:

'as simple, clear and useful as possible. A plethora of peripheral information is more likely to distract than illuminate'.

4 Where an expert's report is included in a notice of meeting, prospectus or PDS, the report must be clear, concise and effective to help the company comply with its statutory obligation under s249L(3), 715A or 1013C(3). This obligation is discussed in our policy proposal paper *CLERP 9 Bill Product disclosure* (April 2004), Policy Statement 168 *Disclosure: Product Disclosure Statements* [PS 168]; and Information Release [IR 04-71] 'ASIC issues guidance on PDS disclosure'.

5 For example, an analysis of the industry in which the company operates is useful, but copying material out of an industry research database may merely add to the length of the report. The expert should include an analysis of the material and relate the material

directly to the opinion. It should not include material if it does not impact the opinion.

Incorporation by reference

6 This proposal is similar to our existing policy in [PS 75.23].

7 The aim of s712 is to reduce the length and complexity of prospectuses, while more technical analysis is available to investors, analysts and advisers: Explanatory Memorandum to the Corporate Law Economic Reform Program Bill para 8.6. It follows that the client should not incorporate by reference an expert's report (or part of it) containing information useful to all investors.

8 The Takeovers Panel commented that a target's statement could have offered holders the option to request a copy of a recent prospectus containing an independent geological report relied on by the independent expert: *Re Namakwa (No 4)* [2001] ATP 15 at [15] and [16]. *Namakwa* had distinctive facts:

- (a) holders had recently received the prospectus; and
- (b) the geological report provided limited information because the mining project was at an early stage.

9 Our relief is not available for an expert's report in a scheme of arrangement because we do not have power to modify Schedule 8.

10 Where s712 or our relief requires the client to identify and describe the expert's report, the expert must consent to that description: s712(3), 716(2), 636(3), 638(5).

Valuation methodologies

11 We do not limit the expert's exercise of skill and judgment in choosing the most appropriate methods of valuation methodology: PN 43.38. However, the expert's choice must not be so manifestly unreasonable that no competent professional person in the expert's position could honestly have made it: *Re Matine* (1998) 28 ACSR 268, 289 (treatment of goodwill by an expert in a scheme of arrangement). A valuation might be misleading because it involves an implied representation that it is the product of the expert's skill reasonably applied: e.g. *Kenny & Good Pty Ltd v MGICA* (1997) ALR 313, 355-7.

12 The Takeovers Panel found that a bidder's valuation of a target based on capitalising the target's earnings might be misleading if it ignores the readily realisable value of other significant assets of the target: *Re EPHS Ltd* [2002] ATP 12.

13 Practice Note 43 lists several methods that the expert may appropriately use: [PN 43.39(a) and (d)]. This list is consistent with recent comments by Barrett J in *Teh v Ramsay Centauri Pty Ltd* (2002) 42 ACSR 354, 35960 on 'accepted methods of company or enterprise valuation'. Experience suggested to Barrett J 'one (or probably more likely all) of':

- (a) 'discounted cash flow approach'; and
- (b) 'regard to the assets and liabilities and, in a notional sense, to the surplus which might be expected to eventuate if the assets were realised in an orderly way'; and
- (c) 'the application of future maintainable earnings'.

Assumptions

14 An express statutory requirement that the expert has reasonable grounds applies to an assumption about a future matter: s728(2), 769C and 670A(2). An opinion might be misleading because it involves an implied representation that it is based on 'a rational foundation by reason of the superior knowledge and expertise of' the expert: *RAIA Insurance Brokers Ltd v FAI General Insurance Co Ltd* (1993) 112 ALR 511, 522.

15 In *Duke Group Ltd v Pilmer* (1999) 31 ACSR 213 the expert used unjustifiably high projections of future maintainable earnings and earnings multiples.

Statements must be supported

16 Experts must undertake such verification as is reasonable in the circumstances: Santow J in *Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77.

17 For example, we might take regulatory action if an expert says that:

- (a) an acquisition of a business will give holders access to increased cashflow without an analysis of cashflow;
- (b) an advantage of a transaction will be increased liquidity where new securities issued will be subject to escrow for a period without noting this; and
- (c) the transaction will result in a re-rating of the securities without an analysis of the reasons for and likelihood of the re-rating.

Range of values

18 Changing our policy that the expert should give a most probable point in a range would put even greater emphasis on the requirement that ranges are narrow.

19 In Policy Statement 163 *Takeovers: minimum bid price principle s621*, we say that without exceptional circumstances, the most probable point in a range will be the mid-point (average or mean): [PS 163.41]. This approach is consistent with the Takeovers Panel decision in *Re Email Limited* (2000) 18 ACLC 708. In the context of s621(3), it is necessary to adopt a single point in a range: [PS 163.40].

Confidential information

20 Experts' reports are often commissioned as part of 'a company's disclosure obligations. There is no exemption for issuers, bidders or targets to omit material information from 'bidders' or 'targets' statements, prospectuses or notices of meeting on the basis it is confidential.

21 The commercial benefits of keeping information confidential are relevant in assessing what is reasonable for investors to require or expect for the purposes of e.g. a bidder's or target's statement: [PS 170.67], s636(1) and 638(1A). But these commercial benefits do not justify withholding information that may influence an investor's decision. This is particularly so where the information significantly affects the valuation.

New circumstances

22 An expert whose report accompanies a target's statement under s640, a bidder's statement under s636(2) or a prospectus must notify the client as soon as practicable if it becomes aware that there has been a significant change affecting the information included in the report: s670C(2) and (3) and 729–730. The supplementary report obligation applies during the bid period or objection period for a compulsory acquisition or until expiry of a prospectus.

23 In other transactions e.g. a scheme, a failure to give a supplementary report might constitute misleading conduct: *ASIC v Solution 6 Holdings Ltd* (1999) 30 ACSR 605; *Duke Group Ltd v Pilmer* (1999) 31 ACSR 213, 272–3. The expert's report operates at the time of the investors' decision, for instance, at the meeting, not the time the expert gives it to the client. The statements in the expert's report constitute ongoing representations that might become misleading.

24 There is a particular risk for the expert where the impact of a change on the expert's report will not be apparent to ordinary investors, e.g. an event undermining an estimate of future earnings: *Duke Group Ltd v Pilmer* (1999) 31 ACS 213, 272–3.

25 Changes affecting valuations in the report are more likely to trigger the supplementary report obligation than tactical events in the progress of the transaction e.g. the level of acceptances in a bid.

26 This proposal is similar to our existing policy: see [PN 43.70].

Client's responsibility

27 If a bidder or target does not send the supplementary report to holders it risks an application to the Takeovers Panel for a declaration of unacceptable circumstances: see Policy Statement 159 *Takeovers: discretionary powers* [PS 159.60].

28 It might be acceptable in all the circumstances that the supplementary report is received by holders only shortly before a meeting is held or towards the end of an offer period: *Troy Resources NL v Taipan Resources NL* (2000) 36 ACSR 197.

D Regulatory action

Policy proposal	Your feedback
<p>Monitoring experts' reports</p> <p>D1 We will conduct selective compliance reviews of experts' reports to determine whether they meet independence and quality requirements.</p> <p>Action</p> <p>D2 We might take regulatory action if we have concerns about the independence of the expert or the quality of its report.</p> <p>D3 We might write to the expert or client or both to raise concerns or request changes to an expert's report. But where delay might prejudice the interests of investors or the market, we might take enforcement action without consulting the expert or client.</p> <p>D4 Where concerns about the independence or quality of an expert's report arise, the expert and client risk action by us or another party. For example:</p> <ul style="list-style-type: none"> (a) in a takeover bid, an application to the Takeovers Panel for a declaration of unacceptable circumstances or other regulatory action; (b) in a scheme of arrangement, opposition to the scheme at a court hearing; (c) action for contravention of misleading or deceptive conduct provisions (s670A–D, 728, 1041E and 1041H) (e.g. <i>Re BNQ Sugar Pty Ltd</i> (1994) 12 ACSR 695); and (d) in the case of a prospectus or PDS, a stop order under s739 or 1020E. 	

Policy proposal	Your feedback
<p data-bbox="277 310 444 344"><i>Licensing</i></p> <p data-bbox="271 380 862 554">D5 Lack of independence or quality in experts' reports can give us grounds for exercising our administrative powers to revoke or suspend the expert's licence, after a hearing: s915C.</p> <p data-bbox="277 579 699 613"><i>Compulsory acquisitions</i></p> <p data-bbox="271 642 837 858">D6 Where an expert's report does not meet independence and quality standards, we might cease or suspend nominating the expert to prepare reports in compulsory acquisitions: s667AA and Policy Statement 159 <i>Takeovers: Discretionary powers</i> [PS 159.107].</p>	

Explanation

1 Santow J said: 'The experts are responsible for what they say in their reports' (*Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, 77). Gyles J in considering liability for an expert's report said that an expert's responsibility is an important aspect of investor protection: *Reiffel v ACN 075 839 266 Ltd* (2003) 45 ACSR 67, 102. He continued: 'The [ASIC] guidelines...underline this by discouraging disclaimers'.

Monitoring experts' reports

2 In schemes of arrangement, we will examine experts' reports in our role of assisting the court to review the content of scheme documents and the nature and function of the scheme: see e.g. s411(2) and ASIC Policy Statement 142 *Schemes of arrangement and ASIC review* [PS 142.4].

Action

3 An expert might be liable for a misleading statement or omission in an expert's report because it e.g.:

- (a) gives a report included in or accompanying a prospectus or bidder's statement, including if it omits disclosure of conflicts (s670A(1)(g) and (k));
- (b) makes a statement about the future without reasonable grounds (s670A(2) or 728(2)); or
- (c) is named in a prospectus or bidder's statement with its consent as having made the statement (item 10 of s670B(1) and item 5 of s729(1)).

4 We discuss stop orders in Policy Statement 152 *Lodgment of disclosure documents* [PS 152.46].

Licensing

5 In 2001, following a private hearing, we imposed an additional condition on a licensee that it must not issue any experts' reports unless a qualified accountant or lawyer approved by us certifies that the report complies with Corporations Act requirements: see [MR 01/421] 'ASIC clips Falconer's wings'. We also discussed licensing action for unsatisfactory reports in [MR 94/97] 'Takeovers—warning on experts' reports'.

Regulatory and financial impact

1 We have considered the regulatory and financial impact of the policy proposals in this paper. Based on the information currently available to us, we think implementing these proposals will strike an appropriate balance between:

- (a) protecting investors by promoting independence, quality and transparency of experts' reports; and
- (b) facilitating transactions in which experts' reports are given and the continuing participation by experts in the market for reports.

2 To ensure that we have achieved an appropriate balance, we are also developing a Regulation Impact Statement (RIS). All RISs are submitted to the Office of Regulation Review. The RIS will identify all the alternative options that could achieve our objectives. The RIS will also include analysis of the benefits and costs of each of the options, including any restriction on competition for different persons affected.

Important details sought from you

3 So that we can more fully assess the financial and regulatory impact of our proposals, in seeking your views, we specifically invite you to comment on:

- (a) possible options that would achieve our objectives; and
- (b) the likely financial impact of the proposals. In particular, give consideration to the costs and benefits of these proposals. Where possible, we are seeking both quantitative and qualitative data.

Any comments that we receive will be taken into account when preparing our RIS.

Development of policy proposal

We have developed this policy proposal paper in light of our regulatory experience of experts' reports. We have also considered e.g.:

- (a) Explanatory Memoranda and draft Bills for the CLERP 9 Act and Corporate Law Economic Reform Program Act 1999
- (b) The following ASIC policies:
 - Practice Note 42 *Independence of experts' reports*
 - Practice Note 43 *Valuation reports and profit forecasts*
 - Policy Statement 74 *Acquisitions agreed to by shareholders*
 - Policy Statement 75 *Independent expert reports to shareholders*
 - Policy Statement 110 *Share buy-backs*
 - Policy Statement 142 *Schemes of arrangement and ASIC review*
 - Policy Statement 152 *Lodgment of disclosure documents*
 - Policy Statement 159 *Takeovers: discretionary powers*
 - Policy Statement 163 *Takeovers: minimum bid price principle s621*
 - Policy Statement 168 *Disclosure: Product Disclosure Statements*
 - Policy Statement 170 *Prospective financial information*
 - Policy Statement 181 *Licensing: managing conflicts of interest*

(c) the following court and Takeovers Panel decisions:

ASIC v Solution 6 Holdings Ltd (1999) 30 ACSR 605
Australian Co-operative Foods Ltd (2001) 38 ACSR 71
Australian Leisure & Hospitality Group Ltd [2004] ATP 21
Re BNQ Sugar Pty Ltd (1994) 12 ACSR 695
Capricorn Diamonds v Investments Pty Ltd v Catto (2002) 41 ACSR 376
Carr Boyd Minerals Ltd v Queen (1987) 7 ACLC 1029
Re Colonial First State Property Trust Group (No 1) (2002) 43 ACSR 143
Re EPHS Ltd [2002] ATP 12
Duke Group Ltd v Pilmer (1999) 31 ACSR 213
Hillhouse v Gold Copper Explorations NL (No 2) (1987) 13 ACLR 208
Re Hudson Conway (2000) 33 ACSR 657
Kenny & Good Pty Ltd v MGICA (1997) ALR 313
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Re Rancoo Ltd (1995) 17 ACSR 206
Phosphate Co-op Co of Australia Ltd v Shears (No 3) (1988) 14 ACLR 323 (Pivot case)
Reiffel v ACN 075 839 226 Ltd (2003) 45 ACSR 67
Re Shine Fisheries Ltd (1994) 12 ACSR 627
Teh v Ramsay Centauri Pty Ltd (2002) 42 ACSR 354
Troy Resources NL v Taipan Resources NL (2000) 36 ACSR 197

(d) the following ASIC releases:

[IR 04-71] ASIC issues guidance on PDS disclosure
 [MR 94/97] Takeovers—warning on experts' reports
 [MR 01/421] ASIC clips Falconer's wings
Report of the investigation into Burns Philp & Co Ltd (1998)

(e) various commentators e.g. McDonald, Moodie, Ramsay and Webster *Experts' Reports in Corporate Transactions* (Federation Press 2003)

Key terms

In this policy proposal these words have the following meaning.

AFS licence An Australian financial services licence

CLERP 9 Act Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act 2004

client In this context, a person who commissions an expert's report

expert An entity (company or firm) that gives an expert's report

FSR Act Financial Services Reform Act 2001

interested party A person that has an interest in the outcome of the transaction different to the general body of holders (other than the client). For example: any person with a substantial interest in the client or a target; an associate of the client; a promoter in a fundraising; if the client is the bidder, the target; or another party to a reconstruction

supplementary report A notification by the expert to the client of a significant change affecting the information included in the report

What will happen next?

Stage 1

February 2005

Policy proposal paper released

Stage 2

Wednesday 27 April 2005

Comments due

Stage 3

June 2005

Two new policy statements
released

Your comments

We invite your comments on the proposals and issues for consideration in this paper.

We will treat your comments as public unless you say otherwise.

Comments are due by Wednesday 27 April 2005 and should be sent to:

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You can also contact the ASIC Infoline on
1300 300 630 for information and assistance.
