



Australian Government
Takeovers Panel

Guidance Note 17 – Rights issues

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Background

1. This guidance note has been prepared to assist market participants understand the Panel’s approach to rights issues which have, or are likely to have, an effect on control or the acquisition of a substantial interest in the company.¹
2. The examples are illustrative only and nothing in the note binds the Panel in a particular case.

Exception for rights issues

3. Section 611² provides exceptions to the prohibition on persons acquiring control of a company in s606. The two relevant exceptions are item 10 and a similar exception in item 13 (see Appendix A).

¹ This note applies also to managed investment schemes

² References are to the *Corporations Act 2001* (Cth) unless otherwise indicated

4. The Panel does not seek to narrow the exceptions. Many rights issues³ will not affect control. Moreover, the fact that control is affected by a rights issue does not of itself give rise to unacceptable circumstances, bearing in mind:
 - (a) the legislation recognises an exception from s606 for rights issues
 - (b) shareholders invest in the knowledge they may be diluted if they do not participate in capital raisings and
 - (c) companies are entitled to manage their capital as they see fit.
5. However, if there is a potential for a rights issue to affect control, the directors should carefully consider all reasonably available options to mitigate that effect. The Panel considers, among other things, whether the control effect exceeds what is reasonably necessary for the fundraising purpose.⁴

Unacceptable circumstances

6. In considering whether a rights issue gives rise to unacceptable circumstances, the Panel looks at the effect of the rights issue against the principles in s602. In doing so, it considers the following factors:
 - (a) the company's situation
 - what methods of raising funds are available to the company
 - whether the company has explored other capital-raising alternatives
 - the financial situation and solvency of the company, including the reasons for raising the funds. How much the company needs funds may influence what is reasonable for it to accept as a potential control effect
 - market factors leading up to the rights issue and those reasonably likely to occur during the rights issue. Market factors have a significant bearing on the structure of a rights issue (below)
 - whether the company received, and followed, advice from financial advisers

³ An issue by the company of new shares offered to shareholders in proportion to their existing holdings, which may be renounceable (ie tradeable) or non-renounceable, and may be underwritten (ie to take up any shares not taken up by shareholders) or non-underwritten

⁴ *Bisalloy Steel Group Limited* [2008] ATP 29 at [21]; *Dromana Estate Limited* 01R [2006] ATP 8 at [43]

- (b) the structure of the rights issue⁵
 - size, price, discount to market, timing, underwriting and renounceability
 - whether the rights issue is underwritten by professional underwriters or sub-underwriters or a related party or major shareholder
 - whether there is a dispersion strategy⁶
- (c) the effect of the rights issue
 - any effect on control or the acquisition of a substantial interest
 - the purposes of Chapter 6 as set out in s602
 - the steps the board has taken to minimise potential control effects
 - disclosure of potential control effects
 - the response, or likely response, of the shareholders (and particularly any substantial shareholders) to the rights issue.

Some factors

Need for funds

7. When considering the company's need for funds, the Panel will look at the company's financial situation, the amount sought to be raised and the suitability of raising capital by the rights issue. The Panel is likely to accept the directors' decision on these issues if the decision appears to be reasonable and supported by rational reasons unless the applicant can point to something that suggests deeper inquiry may be warranted.⁷
8. However, need for funds is not a safe harbour. Notwithstanding a company's need for funds, the Panel may still declare the circumstances unacceptable.

⁵ *InvestorInfo Ltd* [2004] ATP 6 at [38] lists factors relevant to assessing whether a rights issue is genuinely accessible to shareholders

⁶ *Multiplex Prime Property Fund 03* [2009] ATP 22. On review, [2009] ATP 23, the review Panel declined to conduct proceedings

⁷ In *Rey Resources Ltd* [2009] ATP 14, the Panel accepted that there was a need for funds based on the documents submitted by the company. The underwriter undertook to disperse shortfall shares to a number of sub-underwriters

Structure overall

9. Structural matters (such as price, number of shares offered, renounceability, underwriting) cannot be considered in isolation from each other and the market conditions at the time of the rights issue. The Panel will look at the structure of the rights issue as a whole, and the market, in deciding whether the rights issue gives rise to unacceptable circumstances. In practice, if the rights issue is underwritten, the underwriter will usually influence the structure (and may in some cases decide on it).⁸

Pricing

10. Price influences the decision of shareholders whether to take up the rights offer.⁹ The more shareholders take up their rights, the less potential there is for a control effect.
11. The question of pricing is more easily considered in relation to liquid, listed securities because there is a market price against which to compare the issue price for the rights. Unlisted securities, illiquid listed securities or listed securities with a volatile market price may not have a readily accessible price comparison.
12. A small discount to market (or a premium to market) provides less incentive for shareholders to take up the rights offer. It also undermines the effectiveness of renounceability, in mitigating the likelihood of control becoming concentrated with an underwriter or other participating major shareholder.
13. A large discount to market is likely to be attractive to shareholders and encourage them to take up the rights offer (to gain the benefit of the discount). This reduces the shortfall and thus the likelihood of control becoming concentrated with an underwriter or other participating major shareholder. On the other hand, a large discount may have an adverse effect on shareholders who elect not to participate by transferring value to new shares and diluting the shareholders more than would otherwise be the case. This may be particularly so in a large issue.

Size

14. A large rights issue may have a potential control effect, even if priced at a large discount, because shareholders may not have the capacity to

⁸ An example of alternatives being explored, and the interaction of underwriters with the company is structuring the rights issue is *DataDot Technology Ltd* [2009] ATP 13

⁹ Their decision is affected also by other factors, such as the size of the rights issue compared to the company's existing share capital, whether or not the rights issue is renounceable and the effect on the prospects of the company if the rights issue is fully taken up

pay for all the shares. A company undertaking a large rights issue may need to more clearly demonstrate its need for those funds.¹⁰

Renounceability

15. In a renounceable¹¹ rights issue, a large discount is likely to facilitate an active market for the rights. This allows shareholders an opportunity to recoup some of the value transfer by selling their rights.¹² The buyer is likely to take up the rights offer. There is no exception from s606 for buyers who exercise rights.
16. A non-renounceable rights issue may result in greater flow-through to an underwriter or sub-underwriter, so increasing the potential control effect. The effect is exacerbated if the rights issue is underwritten or sub-underwritten by a related party.
17. However, renounceability is not a safe harbour.
18. Non-renounceability may not be a significant factor in deciding unacceptable circumstances if:
 - (a) a market for rights is unlikely (eg, the company is not listed or the stock is illiquid)
 - (b) it is unreasonably costly to make the rights issue renounceable or
 - (c) the market circumstances are such that underwriters for the issue are not available for a renounceable issue (eg, because of the longer term of the underwriting).

Underwriting

19. An underwriter (or sub-underwriter) may acquire control of a company relying on:
 - the second limb of the exception in item 10 of s611 or
 - if a disclosure document has been lodged in relation to the rights issue, the exception in item 13 of s611.
20. Underwriters (sub-underwriters)¹³ may be professional,¹⁴ a related party, an unrelated party or a major shareholder. A professional

¹⁰ The company may also require shareholder approval, for example under the Listing Rules

¹¹ Renounceable rights can be transferred to a third party; non-renounceable rights cannot. Listing and quotation will establish a price and on-market trading of rights can occur, but listing and quotation is not essential to renounceability

¹² Helps meet the reasonable and equal opportunity principle in s602(c). See also *Emperor Mines Ltd 01R* [2004] ATP 27 at [26]

¹³ The underwriter guarantees the funds to be raised by contracting, subject to conditions, to subscribe for shares not taken up by shareholders. A sub-underwriter takes some of that risk by contracting to take some (or all) of the shares the underwriter might have taken

underwriter generally seeks to earn an underwriting fee rather than hold shares, so is unlikely to have any interest in obtaining control of the company, although it may not be able to readily on-sell shares subscribed for under the underwriting agreement.

21. For many companies, a related party or major shareholder is the only realistic source of underwriting (sub-underwriting).¹⁵ Underwriting (sub-underwriting) by a related party or major shareholder does not, of itself, give rise to unacceptable circumstances. However, greater care is needed to mitigate the potential control effects if a related party or major shareholder underwrites (sub-underwrites). The failure of directors to properly canvass professional underwriters or seek out alternatives to a related party or major shareholder underwriter (sub-underwriter) may increase the likelihood of unacceptable circumstances.

Safeguards

22. To mitigate potential control effects of a rights issue, a company might consider the following:
- (a) A dispersion strategy for dealing with the shortfall rather than it flowing through to the underwriter (sub-underwriter)¹⁶

Examples:

 - 1. A shortfall facility for shareholders or others to nominate to take extra shares¹⁷
 - 2. A back-end book-build of shortfall shares¹⁸
 - (b) Using several non-associated sub-underwriters
 - (c) Informed approval by non-associated shareholders of the rights issue and underwriting (sub-underwriting) by related parties.
23. Features which may help a dispersion strategy mitigate potential control effects include:

¹⁴ That is, a person who underwrites in the normal course of their business such as a financial institution or stock-broker

¹⁵ *Emperor Mines Ltd 01R* [2004] ATP 27 at [28]-[30]

¹⁶ For example, *Data & Commerce Ltd* [2004] ATP 7

¹⁷ A facility for shareholders to subscribe for shares not taken up under the rights issue. If the rights issue is underwritten, participation is usually in advance of determining the shortfall available to the underwriter

¹⁸ An offer of shares not taken up under the rights issue to investors - typically institutions - for whom bids are sought, and allotments and issue price determined based on those bids

- (a) an underwriter (sub-underwriter) receiving entitlements under the dispersion facility after all other requests have been satisfied
 - (b) sufficient time and disclosure being offered to shareholders and other investors to assess the rights or shares being offered and
 - (c) external investors being able to take up shares offered under the dispersion strategy.¹⁹
24. The item 10 or item 13 exceptions may not protect an acquisition under a dispersion strategy, whether by existing shareholders or other persons, if the acquisition is not by a person in the capacity of underwriter or sub-underwriter (ie, one who facilitates a capital raising by contracting to subscribe for the shortfall before the offer is made).

Disclosure

25. Disclosure is of increased importance when shareholders are considering the desirability of making a further investment in the company, the control implications of the rights issue and whether to take steps to protect against the dilution of their existing holding.²⁰
26. Rights issue disclosure may be made in different forms under Part 6D.2:
- (a) a full prospectus (with or without a profile statement) under ss709(1) and (2)
 - (b) a “transaction specific” prospectus under s713
 - (c) an offer information statement under s709(4) or
 - (d) a “cleansing notice” under s708AA.
27. Exceptionally, a rights issue may be made without disclosure under Part 6D.2 if it meets the requirements of s708 (a small scale offering, an offering to professional investors, etc).
28. The Panel would expect more disclosure in relation to a rights issue that has more potential control effects (eg, increase in a person’s voting power from 10% to 40%, compared to increase in a person’s voting power from 51% to 55%).

¹⁹ In *Dromana Estate Ltd 01 and 01R* [2006] ATP 4 and [2006] ATP 8 the Panel addressed discretion in respect of, and a cap on, shortfall allocations. It considered that discretion to refuse to accept applications under the shortfall facility was not appropriate, and a cap imposed on individual shareholders under the shortfall facility, which replaced the discretion, was likely to interfere inappropriately with the acquisition of control of shares in *Dromana* in an efficient competitive and informed market. See also *Lachlan Farming Ltd* [2004] ATP 31 at [46]

²⁰ Apart from, where relevant, an understanding of the issuer’s business, financial performance, plans and prospects

29. In considering whether unacceptable circumstances exist, the Panel takes into account:
- (a) the legislative intention for the disclosure required and the type of document used and
 - (b) the adequacy of disclosure in respect of potential control effects.
30. Shareholders will be better able to make an informed decision on participation in a rights issue and its potential control effects if the following is disclosed:
- (a) the possible control scenarios (to the extent they can be)
 - (b) the identities of those who may end up owning any shortfall
 - (c) the reasons behind the choice and roles of any supporting shareholders, underwriters and sub-underwriters
 - (d) the future shareholding pattern of the issuer
 - (e) the intentions for the company of persons who may obtain control (to the extent it can be ascertained by the company)²¹ and
 - (f) the potential effects on control which its proposed dispersion strategy (if any) might cause.
31. Such information would be expected to be found in a full prospectus or cleansing notice because of the requirements in the Act. The Panel thinks it is likely that such information would be required in a transaction specific prospectus. Because an offer information statement is used for small capital raisings, there may be limited control implications. But that may not be so for a company with low capitalisation, and therefore the circumstances may suggest that such information should be disclosed.²²
32. The Panel is not the primary regulator of the disclosure content of rights issues and does not provide detailed guidance on what constitutes complete disclosure.

Managed investment schemes

33. A managed investment scheme must set out in its constitution “adequate provision for the consideration that is to be paid to acquire an interest in the scheme”.²³ This restricts the discretion of the

²¹ This information should be available in relation to underwriters and sub-underwriters but not necessarily major shareholders whose voting power may increase simply by taking up their entitlement in a non-underwritten offer while other shareholders do not

²² *Anaconda Nickel Limited 02-05* [2003] ATP 04 at [69]-[70]

²³ Section 601GA(1)

responsible entity to set an issue price at the time of an issue of interests, but has been modified by ASIC Class Order CO 05/26.

Applications

34. An applicant is likely to have less access to relevant information than the directors of the company. The Panel will take this into account when assessing whether or not to conduct proceedings.
35. Nevertheless, an application needs to demonstrate (by evidence and reasoning) a basis for the Panel's intervention, identifying the effect complained of. The application must be made in a timely manner to minimise potential harm and disruption to the company and shareholders.

Remedies

36. The Panel has wide powers to make orders,²⁴ including to:
 - (a) prevent the rights issue proceeding
 - (b) reopen the rights issue
 - (c) require further disclosure
 - (d) divest shares acquired under the rights issue
 - (e) freeze voting power of shares acquired under the rights issue
 - (f) require shareholder approval of the rights issue or
 - (g) require different underwriting or sub-underwriting arrangements.
37. The question of motive or intention to bring about the unacceptable circumstances is a factor in deciding whether the Panel's preferred orders would unfairly prejudice any person.

Publication History

First Issue 10 January 2006
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²⁴ Section 657D

Appendix: Items 10 and 13 of section 611

Item 10

An acquisition that results from an issue of securities that satisfies all of the following conditions:

- (a) a company offers to issue securities in a particular class;*
- (b) offers are made to every person who holds securities in that class to issue them with the percentage of the securities to be issued that is the same as the percentage of the securities in that class that they hold before the issue;*
- (c) all of those persons have a reasonable opportunity to accept the offers made to them;*
- (d) agreements to issue are not entered into until a specified time for acceptances of offers has closed;*
- (e) the terms of all the offers are the same.*

This extends to an acquisition by a person as underwriter to the issue or sub-underwriter.

Item 13

An acquisition that results from an issue under a disclosure document of securities in the company in which the acquisition is made if:

- (a) the issue is to a person as underwriter to the issue or sub-underwriter;
and*
- (b) the disclosure document disclosed the effect that the acquisition would have on the person's voting power in the company.*