



**In the matter of Dromana Estate Limited 01
[2006] ATP 4**

Catchwords:

declined application; proceedings concluded based on undertakings; undertakings to include additional information; undertaking to extend ex-rights issue date; Rights Issue; Shortfall Facility; underwriting; association; exclusion of foreign shareholders; other material information; prospectus disclosure; undertaking to Panel; voting power

Corporations Act 2001 (Cth) sections: 606, item 10 611, item 13 611,

ASIC Act 2001 (Cth) section 201A

Guidance Note 17

ASX Listing Rules: 7.1, 7.7

Dromana Estate Limited, Tuerong Park Unit Trust; Jinalac Pty Ltd; Alternative Investments Market of the London Stock Exchange (AIM); Authorised Investment Fund Limited

These are the Panel's reasons for declining the application by two shareholders of Dromana Estate Limited, in relation to a 1 for 1 non-renounceable rights issue to be conducted by Dromana. The Panel initially had some concerns as to a related party underwriting agreement, the level of disclosure concerning the company's major asset and submissions as to association. However, on the basis of the undertakings offered by the company and advice as to the process of settling the structure of the rights issue, the Panel accepted the undertakings and declined the application.

SUMMARY

1. On the basis of the explanations provided by the company, and the undertakings offered in relation to disclosure and the structure of the Rights Issue, the Panel declined the Application in relation to a 1 for 1 non-renounceable rights issue to be conducted by Dromana Estate Limited (**Dromana**).
2. The Panel declined the Application on the basis of Dromana:
 - (a) advising that it would terminate an underwriting agreement in relation to the Rights Issue which was underwritten by some of the directors (or associated or related parties) to the sum of A\$1 million¹;
 - (b) advising in relation to a Shortfall Facility which was proposed in relation to shares not initially subscribed for under the Rights Issue, that it would:
 - (i) remove a discretion of Dromana's directors to refuse applications under the Shortfall Facility; and
 - (ii) give shareholders the right to apply for additional shares up to a maximum of 300,000, on the basis that if there are insufficient shortfall shares to satisfy all applications for additional shares, applications would be scaled back pro rata; and
 - (c) undertaking to the Panel to include in a replacement prospectus sufficient information in relation to the Tuerong Park Unit Trust to enable a Dromana

¹ If fully subscribed, the Rights Issue would have raised \$1,566,789.

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shareholder to make an informed assessment of the merits of subscribing for shares in Dromana. The units held by Dromana in the Tuerong Park Unit Trust are Dromana's third most significant existing asset, after inventory and property, plant and equipment.

3. As a result of the above structural changes and the additional disclosure proffered by Dromana in relation to the Tuerong Park Unit Trust, the Panel considered there was no longer any real likelihood that the Rights Issue would give rise to unacceptable circumstances having regard to the effect of the circumstances on:
 - (a) the control or potential control of Dromana; or
 - (b) the acquisition, or proposed acquisition, of a substantial interest in Dromana.

THE PROCEEDINGS

4. These reasons relate to an application (the **Application**) to the Panel from Mr John Hempton, a shareholder in Dromana, and Mr Simon Maher, a director of a corporate trustee for a trust that is a shareholder of Dromana Estate Limited (together referred to as **Shareholders**) on 15 January 2006 in relation to the affairs of Dromana.

THE PANEL & PROCESS

5. The President of the Panel appointed Nerolie Withnall (sitting President), Robyn Ahern (sitting Deputy President) and Chris Photakis as the sitting Panel (**Panel**) for the proceedings (**Proceedings**) arising from the Application.
6. The Panel adopted the Panel's published procedural rules for the purposes of the Proceedings.
7. The Panel consented to the parties being legally represented by their commercial lawyers in the Proceedings.

APPLICATION

Background

8. Dromana is an Australian public company listed on both the Australian Stock Exchange (**ASX**) and the Alternative Investments Market of the London Stock Exchange (**AIM**). Dromana's principal activities are the production and sale of wine. At the time of the Application, Dromana had 26,902,524 fully paid ordinary shares on issue. Dromana also had a number of options on issue with different exercise prices and exercise dates.

Structure, interests and voting power.

9. Dromana's directors are Mr Richard Green, Mr David Craig, Mr Geoff Bell and Mr David Traeger. The directors of Dromana have the following voting power in Dromana (either directly or through associated or related entities):
 - (a) Mr Green has a voting power of 3.06% (being shares held by Mr Green, Paribas Pty Ltd, Deniliquin Development P/L, Isabella Green and Jinalac P/L);

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- (b) Mr Craig has a voting power of 6.09% (being shares held by Mr Craig, Harvard Nominees Pty Ltd, Regent Fine Wines Pty Ltd, Ms Joan Lovell Craig, Dai Li Craig and Jinallec P/L);
 - (c) Mr Bell has a voting power of 3.72% (being shares held by Twelfth Vilmar Pty Ltd);
10. Dromana's major shareholder is Authorised Investment Fund Limited (**AIF**) which owns 5,658,560 ordinary shares in Dromana, approximately 21% of its ordinary shares. AIF has 5 directors including Mr Green, Mr Craig and Mr Chris Ritchie², and two directors with no apparent interests in Dromana.
11. At the time of the proceedings, one of Dromana's main assets was a 29.97% holding in the Tuerong Park Unit Trust (**Tuerong Trust**), which owns a 125 acre property on the Mornington Peninsula. Dromana's directors (and their related entities) had the following holdings in the Tuerong Trust: Mr Craig 23.91%, Mr Green 20.27%, Mr Bell 10.89% and Mr Traeger 3.56%. The trustee of the Tuerong Trust is Jinallec Pty Ltd (**Jinallec**). Jinallec has two shareholders and two directors, Mr Richard Green and Mr David Craig. Jinallec has a voting power of 0.41% in Dromana (this is a direct holding).

Rights Issue

12. On 23 December 2005, Dromana announced that it would undertake the Rights Issue as a non-underwritten 1 for 4 issue. The company later amended its terms by announcement on 28 December 2005 and 9 January 2006. The company advised the Panel that the changes had been due to a previously negotiated finance and trade arrangement falling through on the insolvency of Unwins Wine Group Limited in the UK.
13. On 11 January 2006, Dromana announced that the Rights Issue would be a non-renounceable rights issue of fully paid ordinary shares to existing shareholders at a price of 7 cents per share on the basis of 1 new share for every share held (**Rights Issue**). The terms of the Rights Issue were set out in a prospectus dated 11 January 2006 (**Initial Prospectus**). Offers under the Rights Issue were to be made only to shareholders of Dromana resident in Australia or New Zealand³. As a result, if the Rights Issue was fully subscribed, Dromana would issue 22,382,705 ordinary shares and would raise \$1,566,789.
14. The Rights Issue also contained a facility (**Shortfall Facility**) under which Dromana shareholders could apply for additional ordinary shares in excess of their entitlement if there was a shortfall in original subscriptions under the Rights Issue. Under the Shortfall Facility, the company proposed to fill applications in the order in which they were received. However, the directors of Dromana retained a discretion to reject an application for additional shares should the shortfall be insufficient to meet all applications for additional shares.

² Mr Ritchie is also the company secretary and CFO of Dromana.

³ Approximately 18% of Dromana shares were held by Computershare Clearing P/L as nominee for UK investors who acquired Dromana shares following Dromana's secondary listing on AIM.

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15. Funds raised by the Rights Issue were to be used to fund working capital requirements for an expanded sales and marketing plan together with a debt reduction program and capital expenditure associated with consolidating production facilities at Tuerong Park.

Underwriting

16. The Rights Issue was jointly underwritten (**Underwriting Agreement**) to the extent of \$1,000,000 by:
 - (a) Twelfth Vilmar Pty Ltd (a company associated with Mr Geoff Bell) (**Twelfth Vilmar**) as to 20% of the underwritten shares;
 - (b) Harvard Nominees Pty Ltd (a company associated with Mr David Craig) (**Harvard Nominees**) as to 20% of the underwritten shares;
 - (c) Mr Richard Green and Mrs Isabella Green as to 20% of the underwritten shares; and
 - (d) Jinalec (the trustee of the Tuerong Trust and whose two shareholders and directors are Mr Richard Green and Mr David Craig) as to 40% of the underwritten shares.
17. As mentioned above, Mr Richard Green, Mr David Craig and Mr Geoff Bell are all directors of Dromana. Twelfth Vilmar, Harvard Nominees, Mr Richard Green and Mrs Isabella Green are also financiers of Dromana. The underwriters were to receive a fee of \$50,000, to be paid in the same proportion as they agreed to underwrite the underwritten shares.

The Application

18. The Application alleged the Rights Issue and the Underwriting Agreement gave rise to unacceptable circumstances.
19. The Shareholders submitted that:
 - (a) Dromana may not need the funding it had sought under the Rights Issue;
 - (b) the underwriting might be illegal in that “Jinalec is the corporate trustee for a trust majority owned by Dromana. It is unclear whether Dromana is financing shares in itself (through Jinalec) but if-so this would be prima facie evidence that Dromana does not need the money.”;
 - (c) the Rights Issue and the Underwriting Agreement were mechanisms to cement control of Dromana by Mr Richard Green and Mr David Craig (the **Directors**) at a deflated price;
 - (d) any underwriting should be by an underwriter who was independent of Messrs Craig and Green; and
 - (e) the Rights Issue was excessively large and that this was further evidence that the Rights Issue was an artificial device whose main purpose was to deliver control of Dromana to the Directors.

Interim orders sought

20. The Shareholders sought interim orders under section 657E that:

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- (a) no Dromana shares be issued by Dromana under the Rights Issue to participants or the underwriters until the above application has been determined by the Panel;
- (b) the 19 January 2006 Dromana shares ex-rights trading date (**Ex-rights Trading Date**), be delayed; and
- (c) Dromana be restrained from conducting any related party transactions with the directors or Tuerong Trust, including any new capital transactions in the Tuerong Trust or long term deals (such as rental deals), until the date of the Extraordinary General Meeting which has been requisitioned by Jennifer Anne Hempton, John Lawrence Hempton and Phelbe Pty Ltd.

Declarations sought

21. The Shareholders sought a declaration under section 657A of unacceptable circumstances in relation to the Rights Issue and the Underwriting Agreement.

Final orders sought

22. The Shareholders sought final orders under section 657D:
 - (a) if the Rights Issue was deemed necessary, instead of the present underwriting arrangements, Dromana be required to find a suitable independent underwriter, who would be instructed to prefer independent sub-underwriters;
 - (b) disclosure of the Dromana's interest in the Tuerong Trust and the other relations between Dromana and the Tuerong Trust;
 - (c) the Rights Issue be made renounceable; and
 - (d) Dromana treat foreign shareholders equally as per section 615.

DISCUSSION

Related Party Underwriters

23. The Shareholders, in the Application, submitted that the Underwriting Agreement (as well as the Rights Issue) were mechanisms to cement control of Dromana by the Directors at a deflated price. The Panel notes that the use of related party underwriters in a rights issue does not, of itself, constitute unacceptable circumstances. The Panel accepts that for many companies their nature, size or market following may make it difficult or costly to engage a professional underwriter and that therefore a related party underwriter may be the only realistic source of underwriting.⁴
24. The Panel was initially concerned as to the steps the directors of Dromana had taken to minimise the potential control effects of the Rights Issue, for example by approaching professional underwriters in relation to the Rights Issue or seeking alternatives to the use of related party underwriters.
25. In its submissions, Dromana stated that it had approached two AIM listed investment companies. Dromana had also approached its UK broker about whether

⁴ See Panel Guidance Note 17, paragraph 46.

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it wished to participate in the Rights Issue. Dromana advised the Panel that all of these companies had declined to participate in or underwrite the Rights Issue. Dromana also cited the experience of two of its directors who had recently unsuccessfully sought underwriting for AIF as a basis for turning to related party underwriters.

Disclosure of the Underwriting Agreement in the Initial Prospectus

26. The Panel considered that the disclosure in the Initial Prospectus in relation to the Underwriting Agreement was deficient in not sufficiently disclosing the potential effect of the Underwriting Agreement on control of Dromana. For instance, the Panel was concerned that the Initial Prospectus did not give examples of the size and significance of the effect of the underwriting on control of Dromana if shareholders did not take up their rights under the Rights Issue and the underwriters were required to subscribe for all the underwritten shares.

Application of section 611 to the Rights Issue

27. The Panel was concerned that Mr Craig, one of the directors who was an underwriter could increase his relevant interest in Dromana from 3.6% before the Rights Issue to 23.4% after the Rights Issue⁵. As a result, unless Mr Craig fell within an exception in section 611, there was a potential for a breach of section 606. In addition, there was also the possibility of Mr Green, another director who was also an underwriter, breaching section 606.⁶
28. The Panel did not believe that the Rights Issue fell within item 10 of section 611 and section 615 (see paragraphs 36 and 37 below). In addition, the exception in item 13 of section 611 only applies to an issue to the underwriter of an issue under a disclosure document if the disclosure document sets out the effect the issue would have on the underwriter's voting power in the company. To satisfy that requirement, the Initial Prospectus would need to disclose the underwriters' relevant interests and their voting power (that is, it would have to reflect any associations between one underwriter and another, and with other holders of relevant interests). The Panel informed the parties of its conclusion in relation to this area to give them the opportunity to rebut any of its assumptions.
29. Dromana, in its rebuttals, advised the Panel that it would terminate the Underwriting Agreement, with the consent of the underwriters and without cost to Dromana. The Panel considered, in light of the above, that the concerns which the Panel had in relation to the Underwriting Agreement were no longer relevant.

⁵ This was based on the information supplied by Dromana in its submissions and based on a conservative assumption that the Rights Issue proceeded and only the underwritten shares were issued.

⁶ Mr Green's relevant interest would increase from 2.2% before the Rights Issue to 22.5% after the Rights Issue, although this would fall to 19% after the Rights Issue if Mrs Green's shares were not aggregated with Mr Green's shares. Mr Green and Mrs Green were jointly underwriting 20% of the underwritten shares.

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Dromana board's discretion in relation to the Shortfall Facility

30. The Panel was initially concerned that the Initial Prospectus did not clearly state how the Dromana board intended to allocate shares under the Shortfall Facility when exercising the discretion which was set out in the Initial Prospectus to refuse any application. As a result, Dromana shareholders who wished to apply for ordinary shares under the Shortfall Facility would not know how the directors would exercise their discretion. The Panel advised Dromana that it considered that the Initial Prospectus required further disclosure on how the board proposed to exercise its discretion and what factors the board intended to take into account when exercising such a discretion.
31. In its submissions, Dromana stated that the discretion reserved by directors in relation to the Shortfall Facility was to guard against the possibility of an early applicant for additional shares applying for all the shares available under the facility, thereby depriving other shareholders of any reasonable opportunity to participate in the Shortfall Facility. Dromana stated that directors would only exercise the discretion to reject an application so as to ensure that the Shortfall Facility operated equitably to all applicants for additional shares.
32. In its rebuttal submissions, Dromana further advised the Panel that it would:
 - (a) remove the retention of a discretion by Dromana's directors in relation to the operation of the Shortfall Facility; and
 - (b) give shareholders the right to apply for additional shares up to a maximum of 300,000 each, on the basis that if there are insufficient shortfall shares to satisfy all applications for additional shares, applications will be scaled back pro rata.

The Panel considered, in light of the above, that the concerns which the Panel had in relation to the directors' discretion under the Shortfall Facility were no longer relevant.

Association

33. The Panel noted that it had not received any conclusive evidence of an association between any or all of Messrs Green, Craig and Bell and AIF and that Messrs Green and Craig (who were the only ones who made submissions) denied the existence of any association. The Panel advised Dromana that if Messrs Green, Craig, Bell (along with any entities connected with each of these directors) and AIF were associated (which had not been proven) and that each of these persons and entities took up their entitlement for shares under the Prospectus, that this would result in an increase in the voting power of each of them beyond the three per cent creep exception set out in item 9 of section 611. As a result, if associated, each of these persons who acquired Dromana shares under the Rights Issue would breach section 606 unless an exception under section 611 applied and by an even further amount if each of these entities also took up the maximum amount of shares they were entitled to under the Shortfall Facility.
34. The Panel warned Dromana that it should not knowingly issue shares under the Rights Issue to any person who would acquire those shares in breach of section 606.

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35. The Panel was also concerned that if the persons in the above group were associated, the Rights Issue would (on reasonably possible outcomes) result in a material shift in the degree of control that this group could exert in Dromana. The Panel informed Dromana that this information would be material for any shareholder thinking of subscribing for shares under the Prospectus and should therefore be disclosed by Dromana in the Prospectus if this group were associates.

Exclusion of foreign shareholders

36. The Panel noted that the Rights Issue offers would only be made to shareholders who were resident in Australia and New Zealand. Under section 615, an issuer may exclude foreign holders of a company's securities and retain the benefit of the exception in item 10 of section 611 only if under the terms of the offer:
- (a) the company appointed a nominee for foreign holders of the company's securities who was approved by ASIC; and
 - (b) the company transferred to the nominee:
 - (i) the securities that would otherwise be issued to the foreign holders who accepted the offer; or
 - (ii) the right to acquire those securities; and
 - (c) the nominee sold the securities, or the rights, and distributed to each of those foreign holders their proportion of the proceeds of the sale net of expenses.
37. The Panel was concerned that because Dromana had not appointed a nominee for its foreign shareholders it would not have complied with section 615. As such, the Panel did not believe that any person acquiring shares under the Rights Issue would have the benefit of the exception in item 10 of section 611.
38. Given the size of AIF's existing holding, the Panel was also concerned that AIF may contravene section 606 if it took up all of its rights, unless the exception in item 10 of section 611 was available to it. As noted above, this exception was not available to AIF. Dromana submitted that it understood that AIF did not intend to take up its rights under the Rights Issue. Furthermore, Dromana submitted that AIF was currently conducting a rights issue of its own in order to subscribe for shares in two other companies. If AIF wanted to take up further shares in Dromana, it would have to first raise additional capital. In light of the above, the Panel concluded that it was unlikely that AIF would subscribe for all the shares it was entitled to under the Rights Issue.
39. Dromana submitted that the board of Dromana had decided not to offer shares under the Rights Issue to shareholders resident outside Australia and New Zealand based on a commercial cost/benefit analysis. This decision resulted in the exclusion of all investors who had subscribed for shares in Dromana when it listed on AIM (**UK Shareholders**).
40. Dromana advised the Panel that it had received advice that the cost of producing a complying prospectus for the Rights Issue in the UK would almost outweigh the funds it would raise if all of its UK registered shareholders took up their full entitlements under the Rights Issue. The Panel noted that such a conclusion by Dromana's board appeared to fall within the exception for excluding foreign

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shareholders from the pro rata rights issue under exception 1 of ASX Listing Rule 7.1: see ASX Listing Rule 7.7. However, the Panel was concerned that a company should seek a listing on an overseas exchange, only to exclude these shareholders from an equal access rights issue by that company due to the high compliance costs. Companies looking to list on overseas exchanges should consider the costs of future issues to foreign resident shareholders prior to listing on any overseas exchange.

Disclosure in relation to the Tuerong Trust

41. The Panel noted that the units held by Dromana in the Tuerong Trust are its most significant existing asset (other than inventory and property, plant and equipment). In addition, the Tuerong Trust owns the property on which Dromana conducts the majority of its business and on which its cellar door and winery is constructed.
42. The Shareholders submitted that the Initial Prospectus contained inadequate disclosure in relation to the Tuerong Trust.
43. The Shareholders submitted that:
 - (a) an examination of the Tuerong Trust was necessary in order to answer a number of questions including whether Dromana required the funds it was seeking to raise under the Rights Issue; and
 - (b) Dromana shareholders required adequate information on the current financial and other relationships between Dromana, its directors and the Tuerong Trust in order for shareholders to make an informed decision whether to take up the Rights Issue.
44. The Shareholders argued that the lack of information in relation to the Tuerong Trust suggested that Dromana was setting up the Rights Issue to fail so as to allow control to pass to the Directors through the Underwriting Agreement.
45. The Panel, while not accepting all of the Shareholder's arguments, did believe that the disclosure in relation to the Tuerong Trust to date has been inadequate.
46. The Prospectus represented the largest offering of shares in Dromana since its inception and as such, shareholders who were thinking of subscribing for shares under the Rights Issue were entitled to know the financial details of one of its most significant assets. Furthermore, the Shareholders had indicated that they (as well as entities associated with them) may be willing to subscribe for a large amount of shares in Dromana if they had further details about the Tuerong Trust and its financial position.
47. The Shareholders had also requisitioned Dromana to call a shareholders meeting in order to vote on resolutions relating to the removal of 3 of the 4 current directors of Dromana.
48. As a result, there was potential for a significant change in control of Dromana as a result of the Rights Issue. Shareholders in Dromana were therefore entitled to be given enough information to be able to assess the merits of the current offer.⁷ This would include the disclosure of Dromana's dependence on the Tuerong Trust in

⁷ Section 602(b)(iii).

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order to operate its business and issues such as the relationship between Dromana (and its directors) and the Tuerong Trust and any material contracts between Dromana (including its directors and their associates) and the Trust. At the Panel's request, Dromana has included in the prospectus additional information about the finances of the Tuerong Trust and Dromana's commercial relationship with the Tuerong Trust.

DECISION

49. As a result of the above structural changes to the Rights Issue and the additional disclosures which Dromana undertook to make, Dromana withdrew its Prospectus and provided the Panel with a revised draft incorporating the above information. The Panel advised Dromana that it would not object to Dromana issuing the revised prospectus. The Panel considered there was no longer any real likelihood that the Rights Issue would constitute unacceptable circumstances having regard to the effect of the circumstances on:
- (a) the control or potential control of Dromana; or
 - (b) the acquisition, or proposed acquisition, of a substantial interest in Dromana.
50. Therefore the Panel declined the Application.

Orders

51. As the Panel made no declaration of unacceptable circumstances, it made no orders as to costs or otherwise.

Undertakings

52. The Panel received an undertaking from Dromana that it would delay the Ex-rights Trading Date by 1 week. The Panel received a further undertaking from Dromana to extend the Ex-rights Trading Date by a further week.

Nerolie Withnall

President of the Sitting Panel

Decision dated 14 February 2006

Reasons published 16 May 2006