



**In the matter of Dromana Estate Limited 01R  
[2006] ATP 8**

**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, 608(3), 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, on the basis of an undertaking from Dromana, a review application of Mr John Hempton, a shareholder in Dromana Estate Limited, to make a declaration of unacceptable circumstances in relation to a 1 for 1 non-renounceable rights issue to be conducted by Dromana.**

**SUMMARY**

1. The Panel considered a one for one rights issue proposed by Dromana Estate Limited (**Dromana**). A shareholder submitted that two directors of Dromana were associates of each other and of Dromana's largest shareholder, and that the rights issue was intended to increase the control of the two directors of Dromana.
2. On the basis of undertakings from the company to amend some terms of the rights issue and issue a new prospectus for the rights issue, the Panel declined to make a declaration of unacceptable circumstances.

*Association*

3. The applicant submitted that the significant number of similar investments and common interests indicated that the two directors were associated, and that acquisitions of Dromana shares under the rights issue would breach section 606, as well as consolidating their control over Dromana.
4. The Panel considered the circumstantial evidence which the shareholder, as an outsider, was able to present. However, even allowing for his disadvantage as an outsider, he was unable to provide the Panel with evidence of association between the two directors which was sufficient to override their submissions that they were not associates and that they each pursued their own interests independently of each other.

*Cap*

5. The Panel considered that a cap of 300,000 shares imposed on any individual shareholder under a shortfall facility for the rights issue was likely to interfere inappropriately with the acquisition of control of shares in Dromana in an efficient competitive and informed market. The directors of Dromana submitted that the cap

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had been intended to ensure reasonable opportunity for Dromana shareholders under the shortfall facility. The directors imposed the cap after the first Dromana Panel had required they remove a discretion which the directors had originally retained under the rights issue prospectus, to refuse to accept applications under the shortfall facility if they wished.

#### *Foreign shareholders*

6. The holders of 18% of the shares in Dromana were not eligible to participate in the rights issue because they were resident outside Australia and New Zealand. In large part they were investors attracted to Dromana when it obtained a secondary listing on AIM. The Panel was concerned that a company should list on a foreign exchange, attract investors there, and then deny them access to a rights issue because issuing a prospectus in the foreign jurisdiction would be too costly.

## THE PROCEEDINGS

7. These reasons relate to an application for review made to the Panel by Mr John Hempton on 15 February 2006 (**Review Application**) in relation to the affairs of Dromana Estate Limited (**Dromana**).
8. The Panel met on 28 February 2006 and considered the Review Application and the submissions made in response to the brief dated 21 February 2006.

## THE PANEL & PROCESS

9. The President of the Panel appointed Marian Micalizzi (sitting President), Robyn Pak-Poy (sitting Deputy President) and Byron Koster as the sitting Panel (**Panel**) for the review proceedings (**Proceedings**).
10. The Panel adopted the Panel's published procedural rules for the purposes of the Proceedings.
11. The Panel consented to the parties being legally represented by their commercial lawyers in the Proceedings. Mr Hempton did not retain solicitors to represent him.

## APPLICATION

### Background

12. 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. Further details concerning Dromana, the rights issue and the initial application are set out in *Dromana Estate Limited 01 [2006] ATP 3*.
13. On 11 January 2006 Dromana announced a 1:1, non-renounceable rights issue of fully paid ordinary shares at 7 cents per share, to shareholders with Australian and New Zealand addresses. The rights issue was underwritten by three of the directors of Dromana and associated persons. A shortfall facility was offered, with directors reserving the right to reject applications. The rights issue to raise \$1,566,789 (22,382,705 ordinary shares if fully subscribed). The funds were said to be for working capital requirements for an expanded sales and marketing plan together

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with a debt reduction program and capital expenditure associated with the merging of production facilities at Tuerong Park.

14. An application was made by Mr Hempton and Mr Simon Maher, shareholders of Dromana, for a declaration of unacceptable circumstances and orders based on concerns regarding the rights issue and the underwriting of it. .
15. The Initial Panel declined to make a declaration on the basis that Dromana undertook to:
  - (a) terminate the underwriting agreement (without cost to it);
  - (b) remove the discretion of Dromana’s directors to reject applications for additional shares in the shortfall facility;
  - (c) give shareholders the right to apply for up to 300,000 additional shares (**cap**) on the basis that they will be scaled back pro rata if there are insufficient shortfall shares to satisfy all applications; and
  - (d) include additional information in a replacement prospectus about Tuerong Park Unit Trust (Dromana owns approximately 30% of the units, making this one of its most significant assets).
16. On 15 February 2006 the Panel received the Review Application seeking a review of the Initial Panel’s decision.

### The Review Application

17. The Review Application submitted that:
  - (a) unacceptable circumstance existed in relation to the restructured rights issue (**Rights Issue**)
  - (b) the Initial Panel should have found that:
    - (i) Messrs Craig and Green are associates; and
    - (ii) Messrs Craig, Green, Jinaltec Pty Ltd (**Jinaltec**) and Authorised Investment Fund (**AIF**) are associates.
  - (c) the revised prospectus for the Rights Issue still allowed Messrs Craig and Green, and Jinaltec and AIF to increase their voting power more than the 3% allowed under item 9 of section 611 of the Corporations Act.
  - (d) the cap was evidence of a structure intended to allow Messrs Craig and Green, and Jinaltec and AIF to increase their shareholdings beyond 3% and prevent others from acquiring any significant influence or control in Dromana as a consequence of the Rights Issue.

### Declaration and orders sought

18. Mr Hempton sought a declaration under section 657A of unacceptable circumstances in relation to the Rights Issue and final orders under section 657D that Dromana withdraw the revised prospectus and, as a result, the Rights Issue.
19. In submissions, Mr Hempton stated that an acceptable solution would be for Dromana to:
  - (a) make the Rights Issue renounceable; and

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- (b) extend it to shareholders resident outside Australia and New Zealand (**Foreign Shareholders**).

## DISCUSSION

### Association

20. Mr Hempton submitted initially that Messrs Craig, Green and Bell, and Jinalec and AIF were associates. He subsequently withdrew the submission that Mr Bell was associated with the other parties and the Panel did not consider this further.
21. The following investments and relationships exist between the remaining parties:
- (a) Messrs Green and Craig are directors of Dromana (along with Messrs Bell and Traeger);
  - (b) Messrs Green and Craig are the only 2 shareholders (1 share each) and only 2 directors of Jinalec. Jinalec is the trustee of the Tuerong Park Unit Trust. The trust holds a 125 acre property on which Dromana grows its grapes and makes its wines.
  - (c) Dromana owns approximately 33% of the units in the trust while Messrs Craig and Green (and their related entities) own 24.3% and 20.6% respectively;
  - (d) Messrs Green and Craig are directors of AIF (along with Messrs Hazelgrove and Ritchie - the Chief Financial Officer of Dromana - and Dr Wooldridge);
  - (e) Mr Green (and associated or related persons) has voting power of approximately 17.05% of AIF;
  - (f) Mr Craig (and associated or related persons) has voting power of approximately 17.81% of AIF;
  - (g) AIF has voting power of approximately 21.03% of Dromana;
  - (h) Mr Green (and associated or related persons) has voting power of approximately 3.06% of Dromana;
  - (i) Mr Craig (and associated or related persons) has voting power of approximately 6.09% of Dromana; and
  - (j) Jinalec has voting power of approximately 0.41% of Dromana.
22. Mr Hempton submitted that:
- (a) Messrs Craig and Green are on the Dromana board as the representatives of AIF, a controlling shareholder, and as such must be associates of, or acting in concert with, AIF;
  - (b) Messrs. Craig and Green are major shareholders<sup>1</sup> and directors of AIF, and as such should be presumed to be associated with each other and with AIF for the purposes of controlling AIF's investment in Dromana;

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<sup>1</sup> Together they have voting power of 35% of AIF.

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- (c) Messrs. Craig and Green are the only shareholders and directors of Jinallec (the trustee of the central asset of Dromana's existence);
  - (d) the range of dealings between Messrs. Craig and Green over the history of the formation and operation of Dromana, Jinallec, Tuerong Park Trust and AIF indicate a pattern of acting together which has had the effect of giving them control of Dromana, and should reasonably infer that they are associates.
23. Dromana submitted that it was not aware of any evidence of association between the relevant persons and entities, and that Mr Hempton misunderstood the obligations of a director to act in the interests of Dromana and not AIF (which has 5 directors). Each of AIF and Messrs Green and Craig denied any association.
24. The Panel noted business relationships, investment connections and some consistency of behaviour between various parties.

#### *Association considerations*

25. Determining associations must depend on the facts of the case, and this will often require analysis of complex circumstances. Moreover, the Panel recognises that issues of association are notoriously difficult for outsiders to prove since access to the type of evidence needed is rarely available. Issues of association frequently need to be decided on the basis of inferences from partial evidence, patterns of behaviour and a lack of a commercially viable explanation for the impugned circumstances.
26. When considering association in relation to Dromana, it would be necessary to find the existence of a relevant agreement or acting in concert between the parties said to be associated for the Panel to agree with Mr Hempton's submissions. For example, for Mr Green and Mr Craig to be associates in relation to the Dromana shares they hold directly, there would need to be evidence of a relevant agreement between them, or of them acting in concert in respect of those shares in Dromana.
27. Apart from Mr Hempton stating that associations must exist (for example, in his submission that:
- “Authorised investment fund has clearly been associated with Craig and Green since the foundation of Dromana. At no point, for instance, do Craig and Green differ publicly on the running of Authorised. ....”
- It is not credible that [AIF] is not associated with these Directors [Messrs Green and Craig] both of whom are large stock holders of Authorised and with Mr Green holding additional management control as AIF's Managing Director.”),
28. There was no evidence, patterns of behaviour, uncommercial dealings or other basis provided for the Panel to find or draw inferences that there were relevant agreements or acting in concert. Similarly, there was no evidence which indicated that Mr Hempton's submissions on association should reasonably be preferred to Messrs. Craig and Green's submissions that the similarity of actions was simply a fact of having similar investments and that they were each acting separately in their own interests.
29. The Panel is of the view that there was not sufficient evidence presented to it on which it could find that:
- (a) Jinallec is an associate of AIF;

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- (b) Jinalec is an associate of Dromana;
  - (c) AIF is an associate of Mr. Craig or Mr. Green;
  - (d) AIF is an associate of Dromana; or
  - (e) AIF is an associate of Jinalec.
30. In terms of the Review Application, the Panel is of the view that there was not sufficient evidence presented to it on which it could find that Messrs Green and Craig are associates in relation to Dromana, or that Messrs Green, Craig, Jinalec and AIF are associates in relation to Dromana.

#### *Association through Jinalec*

31. By reason of Mr. Craig and Mr Green's each holding 50% in Jinalec, each of them has a relevant interest in shares held by Jinalec in Dromana: section 608(3) of the Corporations Act. Accordingly each must aggregate Jinalec's holding in Dromana with his own when calculating his relevant interest and any increase. Acquisitions of Dromana shares under the Rights Issue do not get the benefit of the exception in item 10 of section 611 of the Corporations Act because offers are not being made to every person who holds securities in the class (refer to treatment of foreign shareholders). Therefore, Mr Green and Mr Craig must take into account any shares that Jinalec acquires when calculating how many shares each of them may acquire.
32. The Panel considered that Mr Craig and Mr Green may be associates of each other in respect of Jinalec. Under section 12 of the Corporations Act they would be associated with each other in relation to Jinalec if they were:
- (a) parties to a relevant agreement for the purpose of controlling or influencing the composition of the board or the conduct of the affairs of Jinalec (s12(2)(b)); or
  - (b) acting, or proposing to act, in concert in relation to the affairs of Jinalec (s12(2)(c)). This includes business and internal affairs (*National Foods Ltd 01* [2005] ATP 8 at [55]) but cannot be taken too far (highlighted by an example in *National Foods 01* - a covenant in a loan agreement may affect conduct of a business but not create an association).
33. Jinalec has only two shareholders and two directors – Messrs Green and Craig. Mr Hempton submitted that this holding structure for Dromana shares means that they must be associated. The holding company, he said, made it almost impossible for them to act except in concert.
34. Given the operation of section 608(3) it is not necessary for the Panel to make a finding in respect of association in relation to Jinalec. This is because the association is in relation to Jinalec's shares in Dromana and section 608(3) already requires each of them to count Jinalec's shares when assessing their own relevant interests or voting power. Association of Messrs Green and Craig in this respect does not result in aggregation of their relevant interests in Dromana.
35. However, despite the note above that there is no need to make a finding in relation to association in respect of Mr Green and Craig's association in relation to Jinalec, the Panel did not consider that their close proximity in their capacity as the joint shareholders in Jinalec (and therefore the implication that they act in concert in relation to Jinalec's decisions about its holding in Dromana) necessarily meant that

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they might be concert parties in other capacities (eg in relation to their holdings in AIF). Even if Mr Green and Craig did act in concert in relation to Jinalec (which was not found) it would not prove anything about their conduct in relation to their co-investments in AIF for example.

#### Cap

36. The Rights Issue Prospectus said at page five:

*The ability of the Company to satisfy applications for additional shares will be dependent on the extent of any shortfall in applications by shareholders for their full entitlements. Should the shortfall be insufficient to meet all applications for additional shares, the Company (subject to the right reserved by the Directors to reject any application for additional shares) will satisfy applications in the order in which they are received.*

37. The directors of Dromana advised that they originally proposed this discretion to deal with any perceived inequity of distribution between shareholders in any shortfall. The shortfall facility had been structured so that applications would be filled in the order of receipt. The directors submitted they had been concerned that under this regime if a very large shortfall application was received early it might take up all shares available under the shortfall facility and later applicants would receive no additional shares at all. The discretion was removed as part of the Dromana 01 proceedings. In its place the Directors substituted a cap of 300,000 shortfall shares for each applicant (subject to scale back).
38. In this Review Application, Mr Hempton submitted to the Panel that the cap was selected “with the objective of gaining and entrenching control of Jinalec, Craig, Green and [AIF]” in Dromana.
39. Dromana denied this, saying the intention was so that the shortfall facility would operate fairly and in the interests of as many shareholders as possible. Dromana accepted that any figure for the cap would be to some extent arbitrary, but that removing it could result in detriment to smaller shareholders.
40. The Panel accepts that control of a company may be affected by a rights issue and this does not, of itself, give rise to unacceptable circumstances. For an example of circumstances where a declaration of unacceptable circumstances was made in an “underwritten” rights issue, see *Emperor Mines Ltd [2004] ATP 23*.
41. The Panel also accepts that informed, rational shareholders who have reasonable and equal opportunities to participate in any benefits which flow from a rights issue may choose not to participate, with consequential control effects on their company (*Guidance Note 17 Rights Issues - para 7*).
42. If there is potential for a rights issue to affect control, the directors should carefully consider all reasonably available options to mitigate the control effects of the issue.
43. The Panel is not primarily concerned with the motive of the company, but whether the result, or likely result, meets the principles set out in section 602 of the Corporations Act. The Panel considers, among other things, whether the control effects exceed what is reasonably necessary for the fundraising purpose, and whether the acquisition of a substantial interest gives rise to unacceptable circumstances (*Guidance Note 17 Rights Issues - para 10*).

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44. The Panel is mindful of Dromana’s need to raise funds. However, Mr Hempton submitted that the cap “would provide an insignificant contribution to the business.” and that this was evidence that “The purpose of proceeding with the issue is to achieve and entrench control.....”
45. The Panel is also mindful of the desirability for shareholders to maintain their proportional interests if they wish. However, it has concerns that the cap in this case may interfere inappropriately with the acquisition of control of shares in Dromana in an efficient competitive and informed market. While there may be good reasons in a particular case to structure a shortfall differently, as a general rule any shareholder should be able to participate fully in the shortfall subject only to:
- (a) the limits under the Corporations Act that might apply to that shareholder; and
  - (b) the number of shares available given the applications.
46. The cap would seem to reduce Dromana’s chances of having the Rights Issue fully taken up. The Rights Issue reserves to directors control of any shares not taken up to place at any time within 3 months after close of the Rights Issue. The Panel notes that those shares cannot be placed with a director or an associate of a director. This potentially allows outsiders to take shares that shareholders may have subscribed for.
47. Therefore, the Panel advised parties that it was minded to make a declaration of unacceptable circumstances, and order that instead of a numerical cap, the Rights Issue contain a provision to the effect that shortfall applications may be scaled back only if each of the following conditions is met:
- (a) the number of shares applied for under the shortfall facility exceeds the number of shares available for distribution under the shortfall facility, and
  - (b) the applications are scaled back reasonably and fairly having regard to:
    - (i) the number of shares in the shortfall,
    - (ii) the number of shareholders applying for shortfall shares,
    - (iii) the number of shares held by each applicant for shortfall shares, and
    - (iv) the number of shares applied for by each applicant for shortfall shares, and
  - (c) the scaling back is applied as uniformly as possible to all applications.
48. However, Dromana undertook to amend the Rights Issue to remove the cap and substitute a provision to this effect. On that basis, the Panel decided not to make a declaration of uc or orders.

### Renounceability

49. The Rights Issue was non-renounceable. Renounceability allows for a market to be created in the rights. If they have value and there is demand, this may facilitate the rights being acquired and exercised by more persons, which in turn reduces the number of shares not taken up and the potential effect on control of the company.
50. The Panel considers that it is better practice for rights issues to be renounceable unless there are good reasons for non-renounceability. Here, the Panel noted the

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current share price of Dromana and the cost and time involved in changing the Rights Issue to be renounceable. The Panel accepted Dromana's submission that there was unlikely to be a market for the rights given the market price of the shares. Accordingly, while continuing to express its preference for renounceability of rights issues, the Panel concluded that Dromana's rights issue need not be made renounceable.

#### **Foreign shareholders**

51. Dromana was not offering shares under the Rights Issue to Foreign Shareholders based on a cost-benefit analysis. Dromana said that it had advice that the cost of producing a complying prospectus would almost outweigh the funds it would raise if all its UK registered shareholders took up their full entitlements.
52. The Initial Panel noted that this decision affects overseas investors who subscribed when Dromana listed on AIM. The Initial Panel also said that it was unusual for a company to seek a listing on an overseas exchange only to exclude these shareholders from future issues due to high compliance costs.
53. In this Review Application the Panel repeated the concerns of the Initial Panel. It would expect any company considering listing on an overseas exchange to consider the future costs involved, including the costs of making future issues to overseas shareholders.
54. Nevertheless, assuming the cost submitted by Dromana for extending the Rights Issue to UK registered shareholders was accurate, the Panel decided not to require that the Rights Issue be offered also to Foreign Shareholders.

## **DECISION**

55. The Panel considers that unacceptable circumstances existed as a consequence of Dromana's proposed cap on the Rights Issue. However, the Panel considers that those unacceptable circumstances were properly remedied by Dromana issuing a supplementary prospectus which removed the cap and substituted a 'scale back' provision as described above. This was done as part of an undertaking to the Panel in these proceedings. Consequently, it did not appear to be in the public interest to make any declaration or orders.
56. Therefore, under Regulation 20 of the Australian Securities and Investments Commission Regulations 2001 the Panel declined the Review Application.
57. As the Panel made no declaration of unacceptable circumstances, it made no orders as to costs or otherwise. Dromana sought costs, but as the Panel considered that Mr Hempton's application was not frivolous or vexatious, and was pursued expeditiously and succinctly, it would not have been minded to make a costs order against him.

**Marian Micalizzi**

**President of the Sitting Panel**

**Decision dated 2 March 2006**

**Reasons published 16 May 2006**