



Australian Government

Takeovers Panel

**Reasons for Decision
Rey Resources Limited**

2009 ATP 14

Catchwords:

Rights issue – dispersion strategy – shortfall facility – underwriting – sub-underwriting – undertaking – decline to make a declaration

Corporations Act 2001 (Cth), sections 602, 657A

Guidance Note 12: Frustrating Action, Guidance Note 17: Rights Issues

Datadot Technology Limited [2009] ATP 13, Bisalloy Steel Group Limited [2008] ATP 29, Village Roadshow Limited 02 [2004] ATP 12, Midwest Corporation Limited 02 [2008]

INTRODUCTION

1. The Panel, Robert Johanson, Andrew Lumsden (sitting President) and Heather Zampatti declined to make a declaration of unacceptable circumstances in relation to the affairs of Rey Resources after accepting an undertaking from BBY. The effect of the undertaking was to allocate shortfall shares under the Rey rights issue to sub-underwriters to ensure that BBY's voting power in Rey does not exceed 5%.
2. In these reasons, the following definitions apply.

BBY	BBY Limited
Gujarat	Gujarat NRE Minerals Limited
Rey	Rey Resources Limited
rights issue	1 for 5 non-renounceable rights issue announced by Rey on 17 June 2009 to raise approximately \$2.75m
3. In these proceedings, the Panel:
 - (a) adopted the Panel's published procedural rules and
 - (b) consented to parties being represented by their commercial lawyers.

FACTS

4. Rey and Gujarat are ASX listed companies (ASX codes REY and GNM). Gujarat's parent company, Gujarat NRE Coke Limited, owns 16.7% of Rey.
5. On 3 June 2009 Gujarat announced an off-market takeover bid for all the shares in Rey, offering 1 Gujarat share for every 5 Rey shares. It was conditional, among other things, on:
 - (a) 90% minimum acceptance and
 - (b) prescribed occurrences during the period between the date the bidder's statement is given to Rey and the closing date of the bid. One of the prescribed occurrences was that Rey not issue, or agree to issue, any securities.

6. On 3 June 2009, Gujarat's chairman, who was also a director of Rey, resigned from the Rey Board.
7. On 17 June 2009 Rey's directors rejected the bid. The announcement stated that the board of Rey and their associates hold 20% of Rey, and accordingly the Gujarat bid was incapable of succeeding in its current form. The announcement also stated that BBY was Rey's capital markets advisor in respect of the Gujarat offer.
8. In the same announcement, Rey announced that it would undertake the rights issue "to provide additional working capital for Rey and to facilitate progression of the pre-feasibility study and to meet other costs associated with the Canning Basin Coal Project". It stated that the Gujarat chairman was aware of Rey's plans to raise funds.
9. The rights issue was underwritten by BBY. At the time of the announcement, there was no shortfall dispersion strategy disclosed.
10. Gujarat and the directors of Rey both indicated that they would take up their entitlements under the rights issue. If no other Rey shareholders took up their entitlements, BBY could have a holding in Rey of approximately 12%.

APPLICATION

11. On 22 June 2009 Gujarat applied to the Panel for a declaration of unacceptable circumstances in relation to the rights issue.
12. Gujarat made submissions including that:
 - (a) the rights issue would have a significant effect on the consolidation of control of Rey, likely to result in BBY obtaining a substantial interest
 - (b) BBY's intentions regarding the Gujarat bid were arguably not independent of the Rey directors
 - (c) the rights issue could have a significant effect on the decision of Rey shareholders to accept the bid
 - (d) the Rey directors should have considered all reasonably available options to mitigate the control effects of the rights issue and
 - (e) the structure of the rights issue evidenced an attempt by the directors of Rey to frustrate the Gujarat bid.
13. Gujarat sought interim orders that, pending the Panel's final determination of the application, Rey be restrained from proceeding with the rights issue and be prevented from allotting any shares under the rights issue. We considered that there was no need to delay the rights issue, since we were likely to resolve the matter before the scheduled close of the offer period, being 16 July 2009. We advised the parties that we would be prepared to revisit the issue during the course of the proceedings if need be.
14. Gujarat sought final orders including that Rey be restrained from proceeding with the rights issue in its current form, or if the rights issue was allowed to proceed, that a shortfall facility be implemented and BBY announce its intentions in relation to the Gujarat bid.

DISCUSSION

Control effect of the rights issue

15. Gujarat submitted that its voting power in Rey relative to other Rey shareholders should not be 'diluted' by the introduction of BBY as a new 12% shareholder. Moreover, it submitted, there was a concerted attempt by Rey and BBY to consolidate control of Rey shares to frustrate the bid.
16. In the context of a takeover bid, the acquisition by a single party of a 12% interest is significant. It is potentially key to whether the bidder will be able to proceed to compulsory acquisition¹ and in a scrip bid whether rollover relief will be available to accepting shareholders.
17. Gujarat submitted that the directors had not taken all reasonable steps to mitigate the potential control effect of the rights issue because the rights issue was not structured to include a shortfall facility. Such a facility would give all shareholders the opportunity to participate in any shortfall under the rights issue.
18. BBY submitted that it had an appropriate dispersion strategy. Since Gujarat's application to the Panel, it had entered into agreements with 6 sub-underwriters. In light of these new arrangements, the maximum interest in Rey that BBY could acquire under the rights issue would be approximately 2%, and none of the sub-underwriters would acquire an interest of more than 2.25%.
19. Gujarat submitted that a shortfall facility is fairer for Rey shareholders. In *Bisalloy*² the Panel said:
 23. Reasonable steps [to mitigate the potential impact of the rights issue on the control of the company] include (in appropriate cases):
 - (a) seeking to share participation in any shortfall among existing shareholders (for example, by way of a shortfall facility or back end bookbuild) and
 - (b) where the rights issue is to be underwritten or sub-underwritten, seeking to appoint a number of underwriters or sub-underwriters or approaching non-related persons (such as professional underwriters or institutional shareholders) to act as an underwriter or sub-underwriter. (footnote omitted)
20. The sub-underwriting arrangements are sufficient to ensure that the potential control effect will not eventuate. BBY undertook to give effect to the sub-underwriting arrangements. We therefore did not need to consider further whether the rights issue would have an unacceptable effect on the control of Rey.

Frustrating action

21. Gujarat also submitted that the rights issue was a frustrating action. The introduction to GN 12 states:

¹ See for example, *Village Roadshow Limited* 02 [2004] ATP 12 at [37]; *Midwest Corporation Limited* 02 [2008] ATP 15 at [68]

² *Bisalloy Steel Group Limited* [2008] ATP 29 see also *Datadot Technology Limited* [2009] ATP 13 paragraph 31

Action taken by a target company is likely to frustrate a takeover bid if taking that action has a material effect on the objective of the bid. Such action will usually allow the bidder ... to rely upon a condition in its offer, causing the offer to lapse...

22. The Gujarat bid was conditional on prescribed occurrences. It appeared to us that the condition that Rey not issue, or agree to issue, any securities was likely to be breached by the rights issue.
23. Whether the rights issue is a frustrating action giving rise to unacceptable circumstances depends on whether the commercial objectives of the Gujarat bid would be frustrated by it.³ There are two ways in which this could occur:
 - (a) the rights issue could frustrate the bid if it significantly expands the issued capital of Rey, requiring Gujarat to offer significantly more consideration to complete the acquisition. We did not need to finalise our view because the basis for the complaint was addressed by the undertaking or
 - (b) the effect of the rights issue could be that BBY's potential acquisition of a 12% interest frustrates Gujarat gaining control of Rey. The undertaking ensures that BBY cannot acquire more than 5% voting power in Rey.

Undertaking

24. BBY offered, and we accepted, an undertaking to the effect that:
 - (a) it would allocate any rights issue shortfall to the 6 sub-underwriters in accordance with its submission and
 - (b) if it acquired voting power in Rey of 5% or more:
 - (i) it would use its best endeavours to find other sub-underwriters and
 - (ii) to the extent that it was unsuccessful, it would sell down excess shares on market in the ordinary course as soon as practicable (and in any event within 1 month of being issued the shares) to reduce its voting power to below 5%.

A copy of the undertaking is in the Annexure.

25. BBY's undertaking restricts its and the sub-underwriters' voting power to 5%. If any of the sub-underwriters are associates of BBY or each other, their relevant interests will also be captured. Accordingly, we did not need to delve into any questions of association.
26. Given the undertaking, we are satisfied that the circumstances complained of in the application have been sufficiently addressed.

Need for funds

27. It appeared to us that there was a commercial imperative for Rey to conduct the rights issue.

³ See *Guidance Note 12: Frustrating Action* paragraph 13

28. Both GN 12 and GN 17 state that, in considering whether unacceptable circumstances exist, the Panel will consider whether there is a commercial imperative for the company to take the action.⁴
29. Prima facie, Rey appeared to need the funds because:
- (a) financial information provided by Rey revealed that, without the funds, Rey will be in a financially difficult position within 2 months and
 - (b) as an exploration entity, Rey has no sources of operating earnings and therefore needed the funds to continue its ordinary activities, the current focus of which is the completion of a pre-feasibility study for its Canning Basin Coal Project.

DECISION

30. Given the undertaking, Gujarat's complaint was addressed and it was not necessary for us to form any final conclusions as to whether the rights issue was a frustrating action or otherwise had an unacceptable effect on the control of Rey. We therefore declined to make a declaration of unacceptable circumstances and are satisfied that it is not against the public interest to do so.

ORDERS

31. We make no final orders, including as to costs.

Andrew Lumsden
President of the Sitting Panel
Decision dated 7 July 2009
Reasons published 10 July 2009

⁴ See GN 12.32 and *Guidance Note 17: Rights Issues* paragraph 15-20



Australian Government

Takeovers Panel

**Section 201A
Australian Securities and Investments Commission Act (Cth)
Undertaking**

Rey Resources Limited

Pursuant to section 201A of the *Australian Securities and Investments Commission Act 2001* (Cth), BBY Limited (**BBY**) undertakes to the Panel that:

1. it will deal with any shortfall under the non-renounceable rights issue announced by Rey Resources Limited (**Rey**) on 17 June 2009 by allocating shortfall shares to specified sub-underwriters (subject to no sub-underwriter acquiring voting power in Rey of 5% or more) in accordance with its submissions to the Panel dated 30 June 2009 in response to question 5 of the Panel's brief dated 26 June 2009
2. in the event that BBY acquires or anticipates acquiring voting power in Rey of 5% or more:
 - (a) it will use its best endeavours to reduce its voting power in Rey to less than 5% by entering into alternate sub-underwriting agreements, whilst ensuring that no new sub-underwriter acquires voting power in Rey of 5% or more and
 - (b) to the extent BBY is unsuccessful in its best endeavours under paragraph 2(a) and BBY acquires voting power in Rey of 5% or more, BBY will sell down its shareholding on market in the ordinary course to voting power of less than 5% as soon as practicable and in any event within 1 month of being issued the shares
3. it will confirm in writing to the Panel once it has fulfilled its obligations.

**Signed by Mr Arun Maharaj
with the authority, and on behalf, of
BBY Limited
Dated 3 July 2009**