



Australian Government

Takeovers Panel

**Reasons for Decision
Powerlan Limited
[2010] ATP 2**

Catchwords:

Capital raising – effect on control – rights issue – placement – discretion to place shortfall shares – shortfall facility – underwriting – sub-underwriting – need for funds – highly dilutionary rights issue – interim orders – undertaking – undertaking as to damages

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

ASIC Regulation 21(1)

Guidance Note 17 – Rights Issues

Australian Liquor Group Ltd (Interim Orders) [2001] ATP 18, Dromana Estate Limited 01 [2006] ATP 4, Redflex Holdings Limited [2009] ATP 17

INTRODUCTION

1. The Panel, Mike Roche, Robert Sultan (sitting President) and Heather Zampatti, declined to make a declaration of unacceptable circumstances in relation to the affairs of Powerlan in connection with a 4 for 1 renounceable rights issue to be conducted by Powerlan after accepting an undertaking from Powerlan. The effect of the undertaking is to require Powerlan to (among other things) allocate any shortfall shares to shareholders who apply under the shortfall facility on a proportionate basis and disclose in a supplementary prospectus details about the shortfall allocation process and sub-underwriting arrangements.
2. In these reasons, the following definitions apply.

AGIA	Alpha Growth International (Australia) Pty Ltd
Bizzell	Bizzell Capital Partners Pty Ltd
CPS	CPS Group Investments Pty Ltd, a company associated with Powerlan's chairman
Powerlan	Powerlan Limited
prospectus	prospectus issued by Powerlan on 15 January 2010
3. In these proceedings, the Panel:
 - (a) adopted the Panel's procedural rules and
 - (b) consented to all parties being represented by their commercial lawyers.

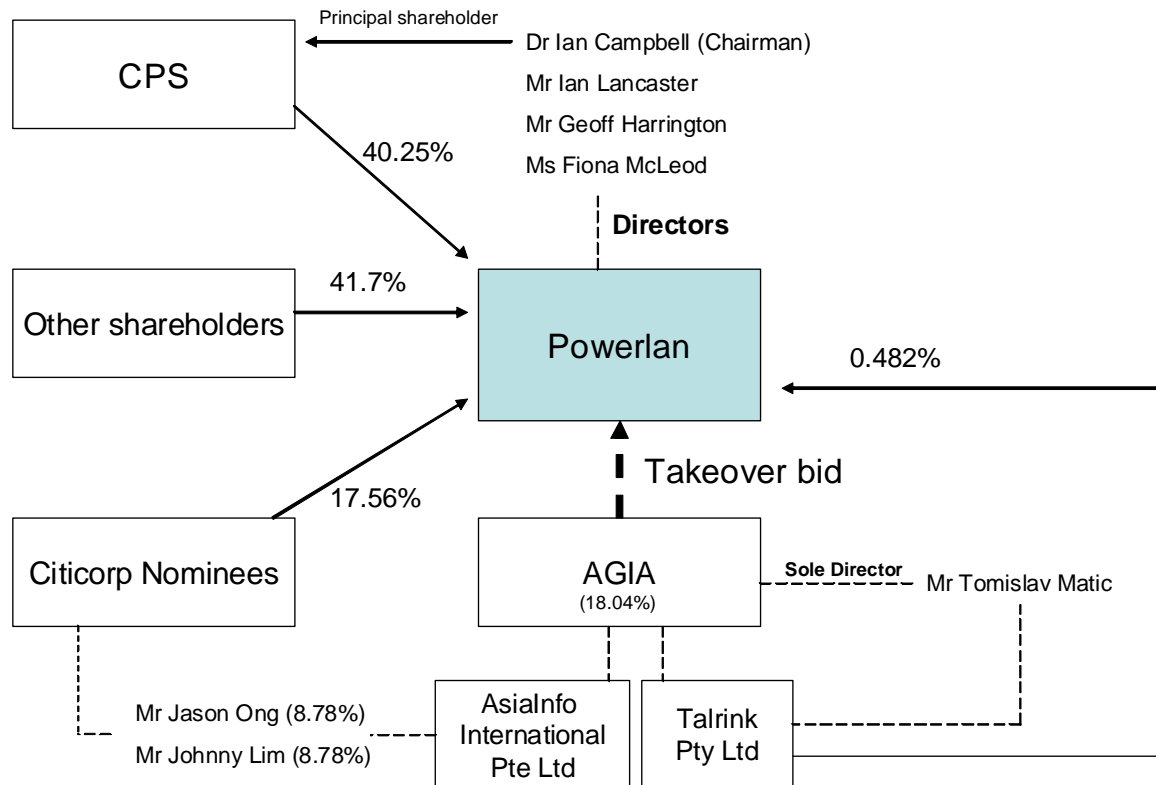
FACTS

4. Powerlan is an ASX listed company (ASX code PWR).

Takeovers Panel

Reasons - Powerlan Limited [2010] ATP 2

- AGIA is a special purpose company incorporated to make a takeover bid for Powerlan.
- The following diagram summarises the board positions and relevant shareholdings in Powerlan:



- AGIA, through its associates, has an 18.04% interest in Powerlan. CPS, an entity controlled by Dr Ian Campbell, Powerlan's Chairman, has a 40.25% interest in Powerlan.
- From March 2009 interests associated with AGIA had approached Powerlan to invest in it. In December 2009 they approached Powerlan regarding financing should it need additional capital. These proposals were rejected by the Powerlan board.
- On 15 January 2010 AGIA announced an off-market takeover to acquire all the issued shares in Powerlan at 10 cents per share. The takeover was conditional (among other things) on 90% minimum acceptance and no prescribed occurrences.¹
- Also on 15 January 2009, Powerlan announced a 4 for 1 renounceable rights issue to raise up to \$19.232 million by issuing up to 330,107,288 new Powerlan shares at 6 cents per share. The terms of the rights issue were set out in the prospectus.
- The prospectus stated that the proceeds would be applied to repay part of the debt owed by Powerlan to CPS, and to have not less than \$6 million available for working capital and to pursue potential acquisitions.

¹ See section 652C of the *Corporations Act*. References are to sections of the *Corporations Act 2001* (Cth) unless otherwise indicated

12. The rights issue contained a shortfall facility for shareholders who wished to take up additional shares in excess of their entitlement if there was a shortfall in the original subscriptions under the rights issue. The Powerlan directors reserved the right to allocate the shortfall at their discretion.
13. The rights issue is underwritten up to \$8 million by Bizzell in the event of a shortfall in subscriptions after the allocation of any additional shares pursuant to the shortfall facility. Under the underwriting agreement, Bizzell could request to be issued further Powerlan shares if the shortfall was less than 133,333,333 shares. This would enable Bizzell to hold that number of shares, but the right to request further shares was subject to a cap referable to the maximum number of shares that may be issued without shareholder approval under the ASX Listing Rules.
14. CPS stated that it would take up its full entitlement under the rights issue for a total commitment of approximately \$8 million.
15. No sub-underwriters were identified in the prospectus.
16. Powerlan shares were to be quoted on ASX on an 'ex' rights basis and trading in the rights was to commence on 19 January 2010. The Panel issued interim orders on 19 January 2010 to postpone the rights issue, which were revoked on 20 January 2010 (see discussion below).
17. On 21 January 2010, Powerlan announced the resumption of the rights issue pursuant to the originally announced timetable, but with rights trading to commence on that date. The record date for determining entitlements was 25 January 2010. The closing date for acceptances is 15 February 2010.

APPLICATION

Application for interim orders

18. AGIA made an application dated 18 January 2010 for interim orders² to the effect that Powerlan postpone the rights issue.
19. AGIA submitted that the "*highly dilutionary*" rights issue was a frustrating action in relation to its proposed takeover. Powerlan made a preliminary submission on the application for interim orders. It submitted (among other things) that if the rights issue was delayed by more than 3 business days, Bizzell was entitled to terminate the underwriting agreement and CPS could revoke its commitment to subscribe for shares, resulting in Powerlan potentially losing \$16 million in guaranteed funding.
20. The President of the Panel, Mr Simon McKeon, considered the application for interim orders and received an undertaking by AGIA to make its application for a declaration of unacceptable circumstances on the basis that the rights issue was a frustrating action by 5.00 pm on 19 January 2010 (annexure A). He made interim orders (annexure B).

² This application, under section 657E, was made before an application under section 657C for a declaration of unacceptable circumstances was made

21. The President noted that “... *The sitting Panel (or the President if no sitting Panel has been appointed or can meet in time) may decide whether to continue the interim orders. If for any reason the interim orders need to be continued, and as a result the underwriting agreement may be terminated because the timetable for the rights issue is delayed by more than 3 business days as set out in the prospectus, then as a condition of continuing them, the Panel (President) may decide to invite submissions on, and consider whether to, require an undertaking from Alpha Growth to the effect that it meet the reasonable costs incurred by Powerlan in the event of termination of the underwriting....*”
22. We considered whether the interim orders should continue. In *Australian Liquor Group Ltd (Interim Orders)*³ the Panel set out relevant considerations for interim orders in the following terms:
- “In these circumstances, we are justified in making interim orders if:*
- (a) the orders prevent some of the harm which might result from unacceptable circumstances, while it is determined whether such circumstances exist and what relief (if any) should be given in relation to the circumstances;*
 - (b) the detriment suffered by those adversely affected by the orders is less than the detriment which would be suffered if no orders were made; and*
 - (c) reasonable precautions are taken to reduce or eliminate the detriment to those adversely affected by the orders.”*
23. The application for a declaration of unacceptable circumstances is based on the rights issue having an unacceptable control effect, not on it amounting to a frustrating action as submitted in the application for interim orders. We did not think that the rights issue proceeding would necessarily inhibit our ability to formulate a suitable remedy in the event that we found that unacceptable circumstances existed. This is because control effects may often (and in this case appeared able to) be dealt with by measures such as an appropriate dispersion strategy. AGIA did not seek final orders other than a declaration of unacceptable circumstances in its application (although it later sought, in response to a Panel inquiry, that the rights issue be withdrawn).
24. On the other hand, Bizzell may terminate the underwriting agreement if:
- “an event specified in the timetable is delayed for more than three business days other than as the direct result of actions taken by the Underwriter (unless those actions are requested by the Company) or the actions of the Company (where those actions are taken with the Underwriter's prior consent).”*
25. Accordingly we did not see any necessary reason to continue the interim orders to postpone the rights issue, and revoked them on 20 January 2010 (annexure C).
26. If AGIA had based its application for interim orders on the rights issue having an unacceptable control effect (as it did in its subsequent application for a declaration of unacceptable circumstances), rather than on frustrating action, it may not have been necessary for the President to have made the interim orders. In our view it was incumbent on AGIA to frame its application for interim orders in the way that it intended to run its application. If there was no sound basis for a frustrating action

³ [2001] ATP 18 at [22]

claim, the application for interim orders should not have been made on that basis. This is not to say such an application would always succeed, but it must be at least arguable.

27. It is very important to ensure that applications for interim orders are soundly based as there may be significant consequences as a result of the orders. In this case the application was supported by an undertaking to make an application for a declaration on the same basis, namely frustrating action. Presumably therefore it was considered an arguable case, although no explanation has been provided for the change.

Application for a declaration

28. By application dated 19 January 2010, AGIA sought a declaration of unacceptable circumstances in relation to the rights issue.
29. AGIA made submissions including that:
- (a) the rights issue was an attempt by CPS to concentrate its shareholding position in Powerlan and ensure a "sympathetic party" acquired a significant stake in Powerlan at a discounted price to dilute other shareholders
 - (b) the amount required to be subscribed by CPS under the rights issue was less than the amount to be repaid to CPS out of the proceeds of the rights issue
 - (c) the rights issue was highly dilutive and had been structured in a way that affected the control of Powerlan
 - (d) the Powerlan board had not reasonably considered other available fundraising alternatives (including by ignoring previous offers made by associates of AGIA) and
 - (e) the prospectus did not disclose that Powerlan had an urgent and compelling need for fresh capital to justify the rights issue.

Final orders

30. AGIA did not specify any final orders in its application for a declaration of unacceptable circumstances. During the proceedings, AGIA sought final orders to the effect that the rights issue be withdrawn.

DISCUSSION

Need for funds

31. Guidance Notice 17 on Rights Issues states at paragraph [17]:

"...the Panel considers that it should not normally second guess the judgement of directors based on grounds and evidence that appear on their face to be reasonable, that their company requires the funds sought in the rights issue, the raising of those funds will be of benefit to shareholders and that the rights issue was an appropriate mechanism."

32. AGIA submitted that Powerlan did not have a bona fide need for funds to justify the rights issue. The prospectus indicated that part of the proceeds were to be used to repay a portion of the debt owed by Powerlan to CPS. AGIA submitted that this debt

was not currently due and no call had been made by CPS for repayment. Under the terms of the CPS loan, the debt is repayable to CPS on 48 hours notice. However, the prospectus states:

“On 23 December 2009, CPS Investments provided an undertaking to the Company that it would not seek repayment of its loan in any amount that would reduce the working capital of the Company below \$6 million, unless CPS Investments, acting reasonably, was of the opinion that an imminent change of control in the Company was likely. This undertaking remains effective until 30 June 2010, after which date it is to be reviewed by CPS Investments and the Company.”

33. This reflects the board minutes of Powerlan and correspondence between CPS and Powerlan.
34. Powerlan submitted that the undertaking had only been given in contemplation of the rights issue and that, if the rights issue did not proceed, the relevant date for the cessation of CPS’s funding support was 26 February 2010 not 30 June 2010. The 26 February 2010 date appears to be derived from a letter given by Dr Campbell to Powerlan’s auditor in connection with Powerlan’s 2008 interim financial report. In that letter, CPS stated to the auditors of Powerlan its current intention to provide support to the company for at least 12 months from the date of signing the interim financial for the half year ended 31 December 2008.
35. In relation to the February deadline, AGIA submitted that:
 - (a) Powerlan had not received any indication from CPS that CPS intended to call the loan (or if such notice had been given, it had not released such notice to the market)
 - (b) the February deadline was introduced only after the Panel proceedings had been initiated
 - (c) the 30 June 2010 date was expressly disclosed by Powerlan as the extent of the CPS funding support and
 - (d) in any event, the proceeds from the rights issue were not sufficient to repay the CPS loan in full, and accordingly, any issues relating to the repayment of the loan would remain regardless of the rights issue.
36. We have not been provided with any documents which continue to support the February deadline. On the basis of the disclosure in the prospectus, we doubt the 26 February deadline, but in the end decided it was not necessary to pursue this matter further.
37. However, it appeared to us that regardless of the deadline Powerlan had reason for conducting the rights issue as there was a need for some, if not all, of the funds. The CPS loan was repayable after 30 June 2010 at the latest, and it was not for us to determine for Powerlan what was the most appropriate time to go to market for funds.

Highly dilutionary rights issue

38. AGIA submitted that the “highly dilutionary” nature of the rights issue (being 4:1) demonstrated that the Powerlan board had not taken reasonable steps to minimise the control impacts of the rights issue.
39. Powerlan submitted that the ratio was a consequence of the deterioration of Powerlan’s financial position. It submitted that the rights issue was not structured to reduce the likelihood of participation. Powerlan made a number of submissions in relation to its financial position, including:
 - (a) it was a small cap company⁴
 - (b) it had suffered significant losses in the three previous years and
 - (c) in the absence of a rights issue, it owed \$19.7 million, repayable to CPS.
40. We accept Powerlan’s submission that the ratio was a consequence of Powerlan’s weak financial position and the fact that it was highly geared.
41. The rights issue is dilutionary and requires shareholders to put up a relatively large additional contribution. But dilution is not itself unacceptable in the absence of a control effect which gives rise to unacceptable circumstances.

Powerlan board’s discretion in relation to shortfall facility

42. We expressed concern that there may be potential for some control effect of the rights issue given that the directors retained the discretion to place any shortfall shares. The prospectus did not indicate how the Powerlan board intended to allocate shares under the shortfall facility when exercising their discretion. As a result, Powerlan shareholders who wished to apply for additional shares would not know how the directors would exercise their discretion.
43. Powerlan offered an undertaking to the effect that additional shares would be allocated on a proportional basis having regard to the shareholdings of the applicants for additional shares as at the record date. This undertaking has the effect of removing absolute discretion on the part of the directors in relation to the allocation of any shortfall (annexure D). In both *Dromana Estate 01*⁵ and *Redflex Holdings Limited*⁶ the Panel accepted an undertaking to remove a similar discretion.
44. Given the undertaking, our concerns have been resolved.

Control effect of the rights issue

45. AGIA submitted that the structure of the rights issue and the underwriting arrangements demonstrated that the Powerlan board had not taken reasonable steps to minimise the control impacts of the rights issue.
46. It further submitted that the structure of the rights issue had been designed to concentrate CPS’s shareholding and ensure that Bizzell acquired a significant interest in Powerlan, which it submitted was a “sympathetic party”.

⁴ Powerlan had a market capitalisation of \$5.78 million (based on Powerlan share price of 7 cents)

⁵ *Dromana Estate Limited 01* [2006] ATP 4

⁶ *Redflex Holdings Limited* [2009] ATP 17

47. AGIA also submitted that, if Powerlan shareholders did not take up their full entitlement under the rights issue, CPS's interest would increase as it proposed to take up its full entitlement.
48. The rights issue was priced at a significant discount (40%), which generally increases the likelihood of entitlements being taken up.⁷ It was also renounceable, which generally decreases the likelihood of potential control effects by enabling third party participation.⁸ There had been no trading of rights at the time of receiving submissions, but there is no evidence that this is a consequence of the structure of the rights issue rather than market choice.
49. Powerlan submitted that even in the most extreme case (assuming no subscriptions other than by CPS and underwritten as to \$8 million), CPS's shareholding only increased from 40.25% to 47.63%.
50. Bizzell submitted that it had an appropriate dispersion strategy. It had engaged nine unrelated, arm's length, professional and sophisticated investors to sub-underwrite the rights issue. Under these arrangements, approximately 85% of any shares it subscribed for under the underwriting agreement (including any further shares) would be allocated to the sub-underwriters, none of whom would be allocated more than 25 million Powerlan shares.⁹
51. The rights issue is a pro rata offer. All Powerlan shareholders may participate and may subscribe for additional shares in a shortfall facility subject to the Corporations Act. We do not have any evidence to suggest that the exception for rights issues has been abused.
52. If any of Bizzell, CPS and any sub-underwriter are associated, the rights issue could potentially result in a material effect on the control of Powerlan. We have not been provided with evidence on which we can form a view that there is or may be an association between any or all of these persons outside the underwriting arrangement. In its submissions, Bizzell indicated that it acted as an underwriter in the ordinary course of its business and that it had no agreements, arrangements or understandings of any nature with respect to its sub-underwriters, CPS or Dr Campbell. Powerlan undertook to issue a supplementary prospectus disclosing that there is no agreement, arrangement or understanding between any of the above persons, other than as contained in the underwriting agreement.
53. There was no disclosure of the sub-underwriting arrangements or their potential control effects in the prospectus. We consider that details of these arrangements should have been disclosed in order to provide shareholders with sufficient information of the likely effect of the rights issue in the event of a shortfall, given that Bizzell had firm commitments to allocate 85% of any shares it subscribed for under the underwriting agreement to its sub-underwriters. Powerlan undertook to issue a supplementary prospectus disclosing (among other things) the sub-underwriting arrangements, including their potential control effects.

⁷ Guidance Note 17, paragraph 25

⁸ Guidance Note 17, paragraph 35

⁹ Approximately 6% of fully diluted capital post-rights issue (assuming fully subscribed)

54. Given the undertaking, we consider that the sub-underwriting arrangements are sufficient to ensure that there is no control or potential control effect on Powerlan that gives rise to unacceptable circumstances.

Issue of further shares

55. The prospectus indicated that Powerlan's obligation to issue further shares to Bizzell was capped to an issue of that number of shares that could be issued without shareholder approval under the ASX Listing Rules. It was unclear to us whether this cap was 61,895,177 shares or some smaller number. Powerlan undertook to promptly clarify with ASX the maximum number of further shares that may be placed to Bizzell under the ASX Listing Rules without shareholder approval, and if different to the number disclosed in the prospectus, to issue a supplementary prospectus disclosing the correct number. Based on this undertaking, we did not consider it necessary to consider this matter further.

DECISION

56. Given the undertaking, we are satisfied that the rights issue is unlikely to have an unacceptable effect on the control or potential control of Powerlan. We therefore decline to make a declaration of unacceptable circumstances and are satisfied that it is not against the public interest to do so.

UNDERTAKING

57. Powerlan offered, and we accepted, an undertaking to the effect that it would (among other things):
- (a) distribute any shortfall shares to shareholders who applied for additional shares under the shortfall facility on a proportionate basis and
 - (b) disclose in a supplementary prospectus details about the shortfall allocation process and sub-underwriting arrangements.

A copy of the undertaking is set out in annexure D.

ORDERS

58. Given that we made no declaration of unacceptable circumstances, we make no final orders, including as to costs.

Post-script

On 2 February 2010, AGIA confirmed that its takeover offer for Powerlan was withdrawn on the basis that the rights issue was a defeating condition under its takeover offer. On 3 February 2010, Powerlan issued a supplementary prospectus for the rights issue.

Robert Sultan
President of the Sitting Panel
Decision dated 29 January 2010
Reasons published 5 February 2010

Annexure A

[Middletons letterhead]

19 January 2010

By email: takeovers@takeovers.gov.au

Takeovers Panel
Level 10
63 Exhibition Street
MELBOURNE VIC 3000

Dear Sirs

Undertaking - Application regarding Powerlan Limited Rights Issue

As you are aware, we act for Alpha Growth International (Australia) Pty Ltd ACN 141 497 770 (AGIA).

On behalf of AGIA and pursuant to section 201A of the *Australian Securities and Investments Commission Act 2001* (Cth), we undertake to make an application to the Takeovers Panel by 5.00pm today that the rights issue proposed by Powerlan Limited is a frustrating action in relation to the proposed off-market takeover by AGIA which amounts to unacceptable circumstances.

Yours sincerely

[Signed]

Rowan McDonald
Partner



Australian Government

Takeovers Panel

Annexure B

CORPORATIONS ACT SECTION 657E INTERIM ORDERS

POWERLAN LIMITED

Alpha Growth International (Australia) Pty Ltd (**AGIA**) made an application to the Panel dated 18 January 2010 for interim orders in relation to the affairs of Powerlan Limited (**Powerlan**).

AGIA has undertaken to make an application for a declaration of unacceptable circumstances in relation to the affairs of Powerlan no later than 5pm on 19 January 2010.

The President **ORDERS**:

1. Powerlan immediately take all action necessary to postpone the commencement of rights trading in relation to its proposed renounceable rights issue to be made under a prospectus dated 15 January 2010 including, if Australian Securities Exchange Limited (**ASX**) requires, any adjustment to the record date or closing date for the rights issue or other aspects of the rights issue timetable.
2. Powerlan make an announcement on ASX as soon as possible regarding the postponement of rights trading and any other relevant adjustments to its rights issue timetable.
3. These interim orders have effect until the earliest of:
 - (i) further order of the Panel
 - (ii) the determination of the proceedings and
 - (iii) 2 months from the date of these interim orders.

Alan Shaw
Counsel
with authority of Simon McKeon
President
Dated 19 January 2010



Australian Government

Takeovers Panel

Annexure C

**CORPORATIONS ACT
SECTION 657E
REVOCATION OF INTERIM ORDERS**

POWERLAN LIMITED

THE PANEL REVOKES the interim orders made on 19 January 2010 postponing the rights issue to be made under the prospectus dated 15 January 2010.

**Alan Shaw
Counsel
with authority of Robert Sultan
President of the sitting Panel
Dated 20 January 2010**



Australian Government

Takeovers Panel

Annexure D

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION ACT (CTH) SECTION 201A

UNDERTAKING

POWERLAN LIMITED

Pursuant to section 201A of the *Australian Securities and Investments Commission Act 2001* (Cth), Powerlan Limited (**Powerlan**) undertakes to the Panel that, in respect of the renounceable rights issue announced by Powerlan on 15 January 2010, it will:

1. deal with any applications for additional shares under the shortfall facility offered under the prospectus dated 15 January 2010 in the following manner:
 - (a) to the extent there is a shortfall between applications received for shares under the rights issue and the total number of new shares to be issued under the rights issue (**First Shortfall**), each shareholder who has applied for additional shares will be allocated their proportionate share of the First Shortfall having regard to their shareholdings as at the record date. If a shareholder has made a shortfall application but has specified a maximum shortfall application amount which is less than the amount of new shares which that shareholder would otherwise be allocated under this process, that shareholder will be allocated the lesser amount and
 - (b) if, following allocation of the First Shortfall, there remains a shortfall between the allocated new shares and total number of new shares proposed to be issued under the rights issue (**Second Shortfall**), the above allocation process will be repeated in respect of the Second Shortfall and any subsequent shortfalls until either all the new shares proposed to be issued under the rights issue have been allocated or all shortfall applications have been satisfied in full.
2. issue a supplementary prospectus which discloses details of:
 - (a) the shortfall allocation process referred to in paragraph 1 above
 - (b) the sub-underwriting arrangements, identifying at least the following details:
 - (i) Bizzell Capital Partners Pty Ltd (**Bizzell**) has engaged 9 unrelated sub-underwriters to assist in underwriting the rights issue (**Sub-Underwriters**). The Sub-Underwriters need not be named
 - (ii) the Sub-Underwriters are arm's length, professional and sophisticated investors

- (iii) Bizzell will disperse not less than 85% of any shares to which it becomes entitled pursuant to the underwriting agreement to the Sub-Underwriters, none of which will be allocated more than 25 million Powerlan shares
 - (iv) there is no agreement, arrangement or understanding between any one or more of Bizzell, CPS Investments Pty Ltd, Dr Campbell and any Sub-Underwriter concerning Powerlan, other than as contained in the underwriting agreement and
 - (v) the potential control effects of the sub-underwriting arrangements on Powerlan
3. promptly clarify with ASX the maximum number of Further Shares that may be placed to Bizzell under ASX Listing Rules without shareholder approval, and if such number is different to the number disclosed in the prospectus, issue a supplementary prospectus which discloses the correct number and
4. confirm in writing to the Panel:
- (a) when it has satisfied its obligations under this undertaking and
 - (b) the final allocations of shares under the rights issue to CPS, Bizzell and the Sub-Underwriters.

**Signed by Jon Newbery
with the authority, and on behalf, of
Powerlan Limited
Dated 29 January 2010**