



Australian Government

Takeovers Panel

**Reasons for Decision
Sherwin Iron Limited
[2014] ATP 12**

Catchwords:

decline to commence proceedings - dispersion strategy - effect on control - funding arrangements - need for funds - no likely orders - rights issue - share purchase plan - shortfall discretion - directors' duties - caretaker directors

Corporations Act 2001 (Cth), section 657A

Guidance Note 17 Rights Issues

Virgin Australia Holdings Limited [2013] ATP 15, Multiplex Prime Property Fund 04 [2009] ATP 21, International All Sports Ltd 01R [2009] ATP 5, Bowen Energy Ltd [2007] ATP 22, Magna Pacific (Holdings) Limited 05 [2007] ATP 16, Dromana Estate Limited 01 [2006] ATP 4, Rivkin Financial Services Limited 02 [2005] ATP 1, Bigshop.com.au Limited 01 [2001] ATP 20

Interim order	IO undertaking	Conduct	Declaration	Final order	Undertaking
NO	YES	NO	NO	NO	NO

INTRODUCTION

- The Panel, Geoff Brunson (sitting President), Mark Darras and James Dickson declined to conduct proceedings on an application by the major shareholder of Sherwin Iron Limited for a declaration of unacceptable circumstances in relation to its affairs. The application concerned a rights issue and share purchase plan. The Panel considered that there was no reasonable prospect that it would declare the circumstances unacceptable given the state of the company's finances, even though the Panel had reservations about the rights issue.
- In these reasons, the following definitions apply.

Sherwin	Sherwin Iron Limited
Citizen Parties	Mr Jerry Ren, Citizen International Investment Pte Ltd and Citizen International Investment Ltd

FACTS

- Sherwin is an ASX listed company (ASX code: SHD). It has 718,228,908 fully paid ordinary shares on issue. It is an iron ore exploration and development company developing the Roper River Iron Ore Project in the Northern Territory.
- The Citizen Parties own approximately 78.17% of Sherwin.¹ In late 2013 to February 2014 they discussed with the Sherwin board a potential 'take-private' transaction.

¹ Mr Ren - 8.23%, Citizen International Investment Pte Ltd - 57.01%, Citizen International Investment Ltd- 12.94%

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5. On 30 May 2014, representatives of the Citizen Parties met with Sherwin to discuss a proposal under which:
 - (a) Mr Ren and independent directors suggested by him would be appointed to the board
 - (b) Mr Barry Coulter (Chairman) would resign as Chairman and be appointed Deputy Chairman
 - (c) Mr Rodney Illingworth (executive director) would limit his executive role significantly or resign as a director
 - (d) Ms Lillian Savage would resign as a director and
 - (e) certain governance measures would be implemented.
6. On 2 June 2014, Sherwin announced that it had terminated discussions with respect to the take-private transaction.
7. On 4 June 2014, Mr Coulter resigned as a director of Sherwin.
8. On 5 June 2014, Mr Peter Heading joined the board as a director.
9. On 6 June 2014, Sherwin announced a 1:1 non-renounceable rights issue and share purchase plan offering shares at 5c² to raise \$40.91 million to further develop its Roper River iron ore project. Eligible shareholders could participate in either or both.
10. On the same day, Mr Ren demanded withdrawal of the rights issue and share purchase plan, and issued a shareholder meeting requisition under section 249D³ to replace the board.
11. On 10 June 2014, Ms Savage resigned as a director of Sherwin.
12. On 11 June 2014, Ms Weifeng Li resigned as a director of Sherwin.
13. On 13 June 2014, Mr Mark Leahy was appointed as a director of Sherwin.
14. The share purchase plan is scheduled to close on 30 June 2014. The rights issue is scheduled to close on 4 July 2014. The s249D meeting is scheduled to be held on 5 August 2014.

APPLICATION

Declaration sought

15. By application dated 19 June 2014, the Citizen Parties sought a declaration of unacceptable circumstances. They submitted that:
 - (a) the rights issue and share purchase plan were proposed despite, or in response to, the proposal put to Sherwin by the Citizen Parties

² On 4 June 2014, the last date Sherwin traded before the rights issue and share purchase plan were announced, the Sherwin share price closed at 6.3c

³ References are to *Corporations Act 2001* (Cth) unless otherwise indicated

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- (b) Sherwin did not have any urgent need for the \$40.91 million proposed to be raised
- (c) the structure of the rights issue (and associated placement of shortfall shares) and the share purchase plan potentially diluted the Citizen Parties to a punitive extent, despite the lack of need for that scale of fund raising and
- (d) the structuring and timing of the rights issue and share purchase plan - in particular the ability of the directors to place the (likely significant) shortfall in their discretion - were unfairly dilutive of, and in the context of the shareholder meeting requisition, undermined, the control position of the Citizen Parties to an extent that the conduct in proposing them constituted unacceptable circumstances.

Interim orders sought

- 16. The Citizen Parties sought interim orders to the same effect as the final orders it sought, if final orders were not made by 30 June 2014.
- 17. Sherwin provided an undertaking not to process acceptances under the share purchase plan prior to 7 July 2014 (Attachment A).

Final orders sought

- 18. The Citizen Parties sought final orders to the effect that Sherwin be restrained from:
 - (a) proceeding with the rights issue and share purchase plan and from placing any shortfall shares and
 - (b) making any similar proposal until after the s249D meeting.

DISCUSSION

Preliminary submission

- 19. Sherwin made a preliminary submission that the Panel should decline to conduct proceedings because:
 - (a) it had a genuine need for the fundraising, and if the Panel made the orders sought its ability to continue as a going concern would be uncertain
 - (b) the structure of the fundraising was appropriate, the directors having considered reasonably available options to mitigate any control effect and
 - (c) when Sherwin announced the proposed rights issue and share purchase plan its directors were not aware of the intention to requisition a meeting.
- 20. Prior to determining whether we should conduct proceedings, we asked preliminary questions seeking to establish why there was a need for funding to be sought prior to the s249D meeting, why the s249D meeting was necessary given that the requisitioning parties controlled 78% of Sherwin, and why there had been various board changes already.

Directors' duties issue

21. The Citizen Parties submitted that the Sherwin Board should be acting as caretaker in view of the “*pending requisitioned meeting at which the composition of the Sherwin board will inevitably change*”. The doctrine of caretaker director is not settled in Australia,⁴ something the Panel has previously noted.⁵ In any event, the Panel is reluctant to get involved in questions about whether the actions of directors (in this case, in conducting the rights issue and share purchase plan) might breach directors' duties.⁶
22. We are concerned about the timing of the s249D meeting relative to the capital raising. The meeting was convened as late as possible, but we confined our consideration to the effect of the rights issue and share purchase plan.

Structure of the capital raising

23. We have some significant reservations about a number of aspects of the capital raising.
24. First, its size. This is a very large rights issue. It is non-renounceable and very likely to be significantly undersubscribed. The Citizen Parties submit that Sherwin was aware that they did not have the capacity to participate. If this is correct, it raises serious questions about the structure of the rights issue. However we have not had the benefit of submissions. As well, we note there may be some confusion surrounding this issue. In September 2013, Mr Ren represented to Sherwin's auditor that he intended (for the purpose of that financial year's statements) “*to support any proposed rights issue announced by the Group by taking up my entitlement, to enable the group to continue as a going concern.*”
25. The rights issue, together with the share purchase plan, potentially more than doubles the number of shares the company has on issue.
26. Second, timing. Accepting Sherwin's urgent need for funds (see below), we also query why the directors could not have held the s249D meeting much sooner. We note Sherwin's submission that it was unaware of the intention to requisition a meeting, but it is clear that there had been ongoing discussions about changes to the board.
27. While the circumstances in *Riokin*⁷ were different, that matter makes it clear that the Panel will take timing into account when considering whether unacceptable circumstances arise in relation to a rights issue.
28. Third, discretion regarding placement of shortfall shares. While shareholders were offered shortfall shares, the directors reserved “absolute” discretion to allot any

⁴ *Ford's Principles Of Corporations Law*, Lexis Nexis Butterworths, 2000 at [7.41.6]

⁵ *Bigshop.com.au Limited 01* [2001] ATP 20 at [80(j)]

⁶ *Magna Pacific (Holdings) Limited 05* [2007] ATP 16. See also *Multiplex Prime Property Fund 04* [2009] ATP 21, *International All Sports Ltd 01R* [2009] ATP 5 and *Bowen Energy Ltd* [2007] ATP 22

⁷ *Riokin Financial Services Limited 02* [2005] ATP 1 at [58]-[61]

shortfall. The Panel does not accept that directors can reserve the discretion without disclosing how they intend to exercise it.⁸

29. We also looked at the lack of underwriting and non-renounceability, but in the end, as there are arguments both ways, did not feel strongly that in this case these were necessarily indicators of an effect on control giving rise to unacceptable circumstances.

Need for funds

30. Sherwin submitted that its short-term funding need was a major driver, and remained critical, and there was also a genuine medium-term funding need. It submitted that an equity raising was the only feasible funding alternative available to it.
31. In Guidance Note 17 the Panel says, when considering need for funds, that it will look at the company's financial situation, the amount sought to be raised and the suitability of raising capital by the rights issue.⁹ The Panel notes that need for funds is not a safe harbour.¹⁰
32. Sherwin's current financial position is dire and its need for funds in the short term evident. We note that the decision by the Citizen Parties not to participate in the rights issue will result in a very significant shortfall. An unsuccessful capital raising could spell the end of the company.

Effect

33. The effect complained of by this rights issue and share purchase plan is potential dilution of the major shareholder. The Citizen Parties submitted that the rights issue and share purchase plan were "*an artifice to defeat an existing significant majority shareholder's controlling interest*". We do not need to decide if this is a control effect captured by s657A,¹¹ in part because the rights issue is incomplete so the actual shortfall, and any exercise of discretion in relation to it, is not known.¹²
34. We note the preliminary submission of Sherwin that there is no current proposal to place any of the shortfall shares because "*Sherwin has not identified any person (or persons) willing to subscribe for (or underwrite) any material number of shortfall shares*".
35. Moreover, the Citizen Parties' decision not to participate in the rights issue contributes to the circumstances complained of.

⁸ see for example *Dromana Estate Limited 01* [2006] ATP 4 at [30]

⁹ Guidance Note 17 *Rights Issues* at [7]

¹⁰ Guidance Note 17 *Rights Issues* at [8]

¹¹ As to this, see *Virgin Australia Holdings Limited* [2013] ATP 15 at [32]

¹² *Post script: on 7 July 2014 Sherwin announced that it had raised \$80,880 from the rights issue and \$92,000 under the share purchase plan, which amounts were insufficient to meet its funding needs and it was in discussion with its major lender to allow drawdown of funds. It also said the shares under the rights issue and share purchase plan would not be issued, and the money would be held in trust, pending resolution of the continuing funding discussions. On 11 July Sherwin announced that the directors had resolved to place the company in voluntary administration*

Likelihood of orders

36. The applicant seeks orders not to proceed with the capital raising, or any like capital raising, until after the s249D meeting. It is unlikely that we would make the final orders sought by the Citizen Parties given Sherwin’s need for funds.

DECISION

37. For the reasons above, on balance, we do not consider that there is any reasonable prospect that we would make a declaration of unacceptable circumstances in this very unusual situation.
38. Accordingly, we have decided not to conduct proceedings in relation to the application under regulation 20 of the *Australian Securities and Investments Commission Regulations 2001* (Cth).
39. If a change in control in Sherwin occurs or appears likely as a result of the placement or proposed placement of shortfall shares, the Citizen Parties, or a person interested, could make a fresh application.

Orders

40. Given that we have decided not to conduct proceedings, we do not (and do not need to) consider whether to make an interim order.
41. As this determines the proceedings, the undertaking Sherwin gave has ended.

Geoff Brunson
President of the sitting Panel
Decision dated 3 July 2014
Reasons published 15 July 2014

Advisers

Party	Advisers
Citizen Parties	Herbert Smith Freehills
Sherwin	Minter Ellison



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Annexure A

**AUSTRALIAN SECURITIES AND
INVESTMENTS COMMISSION ACT 2001 (CTH) SECTION 201A
UNDERTAKING**

SHERWIN IRON LIMITED

Sherwin Iron Limited undertakes to the Panel that it will not issue or allot any new shares under the share purchase plan announced by it on 6 June 2014 until the earliest of:

- (a) Monday 7 July 2014
- (b) order of the Panel otherwise preventing issue and allotment and
- (c) the determination of the proceedings.

**Signed by Rodney Illingworth, Director
with the authority, and on behalf, of Sherwin Iron Limited
Dated 27 June 2014**