Law Council
OF AUSTRALIA

Business Law Section

3 April 2018

Takeovers Panel
Level 10
63 Exhibition Street
MELBOURNE VIC 3000

By email: takeovers@takeovers.gov.au

Dear Sir/Madam

Guidance Note 17 Rights issues

The Corporations Law Committee of the Business Law Section of the Law Council of Australia (**CC**) welcomes the opportunity to provide this submission to the Takeovers Panel (**Panel**) on the Consultation Paper on Guidance Note 17 – Rights issues (**Guidance Notes**).

Introductory and general comments

In summary, the CC considers that the proposed amendments to the Guidance Notes are useful and improve the quality of the guidance provided.

However, the Panel should avoid being too prescriptive in relation to statements about the exercise of its discretion to make declarations of unacceptable circumstances in relation to rights issues. The Panel should have regard to the circumstances of each case and the *actual* effect on control, or (when considering circumstances in advance) that there is a *real and substantial risk* of an effect on control that is *unwarranted* in the circumstances.

Indeed, the Panel should be positively disposed to adopting a "wait and see" approach to rights issues – if there is in fact no effect on control, there is no warrant for the Panel to intervene. Even if there is an actual effect on control, that effect might not warrant Panel intervention.

The Panel should only intervene in advance when the circumstance clearly warrant intervention and by analogy to a court's approach to injunctions, where the balance of convenience favours a restraining order and another subsequent order of the Panel would not be able to address the circumstances – but this would rarely be the case because any effect on control could readily be addressed by orders in relation to voting of shares or disposal of shares.

If a company has a genuine need for funds (and the Panel should not second guess the genuine and reasonable views of the board of the company) there should be a high threshold before the Panel should intervene at all. The relevant exceptions in section 611 should be given their full effect, subject only to intervention when the exceptions are being

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exploited or gamed - that is, where an exception is being used for a purpose outside the spirit of the provision.

There will be cases where a related party underwriter is the only available source of equity funds and, if all other shareholders have been given a reasonable and equal opportunity to participate in the capital raising, it is not presumptively unacceptable that a related party's interest increases because they take up their entitlement and others do not, or that a related party is prepared to underwrite and no one else is prepared to do so.

Recognising that the Panel's jurisdiction is such that each case must be decided on its own facts, it would be presumptively unacceptable if a related party manufactured a situation and used that opportunity to unfairly obtain control. It is also conceivable that a related party exploiting the financial weakness of an issuer to obtain control would be unacceptable. However, if a related party obtaining control is merely an *incidental* outcome of a genuinely required capital raising, that is not inherently unacceptable.

Against this backdrop, the Panel's guidance should not be, or be understood by the market as, a prescriptive set of requirements that must be complied with in all cases.

Rather, the taking of reasonable steps to mitigate any control effect, including implementing a dispersion strategy that is appropriate to the circumstances, should be regarded as prophylactic or creating a safe harbour – if these elements are present, unacceptable circumstances are unlikely to arise, but their absence does not imply that unacceptable circumstances will arise or are likely to arise.

It follows that the amendments to the Guidance Notes should make this clear. This objective could be achieved by adding to the opening words of new paragraph 7.

Specific responses

1. ***Are proposed paragraphs 7 to 10 useful?***

   Generally, yes, subject to the above comments. Paragraphs 7 to 10 provide some additional guidance, albeit largely reflecting the decided cases. Paragraph 8(c) does not add much to the prescribed timetables under the ASX Listing Rules and mandatory content requirements under the *Corporation Act* (Cth).

   Please identify any amendments you think should be made to proposed paragraphs 7 to 10.

   Paragraph 7(b)(ii) should be amended to make it clear that allocation in proportion to shareholdings is not required, merely one acceptable measure. Other methods of allocation may also be acceptable. Likewise, paragraph 7(b)(iii) should be amended to make clear that a discretion on the part of directors is not inherently evil; rather it is the exercise of that discretion that could be problematic. The absence of a discretion is therefore prophylactic but its mere presence is not fatal.

   Paragraph 7(b)(iii) should also be amended to recognise that a cap may be appropriate for other reasons, for example to avoid a breach of other legislation such as the *Foreign Acquisitions and Takeovers Act 1975* (Cth).

Paragraph 7(d) is out of context – informed approval will not "mitigate potential control effects" and is an alternative to such mitigation.

Paragraph 8(a) could be clarified – are the sub-underwriters not to be associated with each other, the issuer, the underwriter, or someone else? Or all of the foregoing? We assume that the terms "associate" and "related party" are used in their *Corporations Act 2001* (Cth) senses, but there could be value in avoiding uncertainty that could exist in the minds of some readers.

Paragraph 10 should be amended to clarify that a shareholder causing or inducing a need for funds is not of itself problematic and that a shareholder exercising a right to be repaid or declining to further extend credit should not of itself be problematic. The manufacture or contrivance of a need for funds in order to obtain control is, however, problematic but this is an important distinction and the guidance needs to be clearer in this regard. At present, the paragraph perhaps will prejudice issuers with a genuine need for funds but without access to professional underwriting.

2. ***If there is a clear need for funds and an appropriate dispersion strategy has been put in place, are structural issues, such as the pricing and size of the rights issue, still relevant in determining whether the rights issue is unacceptable?***

Yes, in principle, structural issues remain relevant. For example, a patently unattractive price may be problematic.

Is footnote 20 appropriate?

Yes, but we suggest that the comment should be elevated to the text.

3. ***Do you agree with proposed footnote 30, which states that unacceptable circumstances may arise if an underwriter is interested in control, rather than merely laying off the risk of holding shares?***

No.

Please explain.

The footnote should be amended to be clearer, such that the point that it makes is that an underwriter whose *principal objective* is obtaining control may give rise to unacceptable circumstances, or more correctly a transaction which has the apparent principal objective of securing control to an underwriter may give rise to unacceptable circumstances.

The possibility of the underwriter obtaining an investment, even a large investment, could be a motivation even for a professional underwriter. Indeed a professional underwriter may in particular circumstances be indifferent to that outcome and have the balance sheet capacity to assume that risk. In other words, no inference should necessarily be drawn from a lack of full sub-underwriting of an issue. However, the footnote suggests that any rights issue where the underwriter is not "laying off the risk of holding shares" will give rise to

unacceptable circumstances and that suggestion is not correct – the question is whether there is an unacceptable effect on control or an unacceptable risk of an effect on control and this question cannot be answered solely by reference to whether or not the issue is sub-underwritten.

We also reiterate that there will be some situations where the only available underwriter may well be interested in control and/or be a related party. If a company in financial distress has a demonstrable need for funds and no alternative source of funds, the risk that a shareholder may obtain or increase control does not necessarily lead to a conclusion that unacceptable circumstances will arise. The village should not be burnt in order to save it.

4. ***Do you agree with the minor amendments made to the Guidance Note?***

Yes.

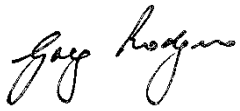
Please identify any other amendments you think should be made.

Paragraph 22(c) could be amended to remove the words in brackets, given that in relation to accelerated offers at least, the timing difference is not material.

I trust these observations are of assistance.

Please contact Shannon Finch, Chair of the Corporations Committee at Shannon.finch@au.kwm.com on 02 9296 2497 in the first instance, if you require further information or clarification.

Yours faithfully



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