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Emergency public company capital raisings during COVID-19 crisis

ASIC and ASX announced temporary measures to facilitate low doc emergency equity offerings on 31 March. These measures, along with others that may be announced by Treasury shortly, will make it easier for public companies to offer new shares without a shareholders' meeting or prospectus. A lot of companies will use this method of fundraising in coming weeks, particularly where one or more major shareholders have cash and are prepared to re-invest in the company.

The temporary changes include:

- increasing the maximum number of days a company may be suspended from trading in the previous 12 month period in order to qualify for low doc offering relief to 10 days;
- a company can now go into back to back trading halts of up to 4 trading days to plan a capital raising. This allows a company to stay in "halt" a little longer before going into "suspension" which will enhance the ability to use the low doc regime;
- an uplift in the 15% placement capacity in rule 7.1 to 25%, subject to there being a follow-on accelerated pro rata entitlement offer or SPP offer; and
- for non-renounceable rights and entitlement offers, a relaxation of the cap on shares being offered exceeding 1:1 of shares held.

Getting the Balance right

Directors must be particularly vigilant about balancing the interests of the company against the interests of existing shareholders when they use a placement, rights issue or SPP as a method of capital raising. It is inevitable that some shareholders will increase their stake in the company and others will be diluted, which raises important conflict issues. *Both ASX and ASIC also issued specific warnings on 31 March emphasising that directors have an obligation to get this balance right*. Directors who do not manage these conflicts properly may face personal liability and minority shareholders may seek to challenge the validity of the capital raising. Minority Shareholders – either by themselves or by class action – can bring actions for oppression and breach of fiduciary duties.

Piper Alderman has the latest comprehensive experience in advising on these conflict issues

The Corporate and Securities law team at Piper Alderman has been at the forefront of these issues in recent months advising directors of issuers, advising major shareholders and also acting for minority investors objecting to being diluted.

In late 2019 and early 2020, Piper Alderman partners Mark Williamson, Gordon Grieve and James Dickson ran successful Australian Takeovers Panel proceedings against Rio Tinto and Energy Resources of Australia (**ERA**) over ERA's emergency capital raising that was underwritten by ERA's major shareholder, Rio Tinto – at the expense of all minority shareholders who were diluted. Our Piper Alderman team was constantly proven correct about how that emergency capital raising should have been conducted and how the Board of ERA should have managed the conflict between making decisions in the best interests of ERA as opposed to decisions in the interest of Rio Tinto.

Those Takeover Panel reasons are available here: ERA Decision 2019 and here: ERA Decision 2020

Key Issues

Directors' Duties

Directors need to carefully consider, and document, that a transaction is in the best interests of company, and not just in the interests of one or more major shareholders or placees. Whilst these two positions are not necessarily in opposition, directors' duties play a crucial role in protecting minority shareholders and if those duties are not followed, significant liability for directors can result.

Governance and Independence

Directors and Management may be conflicted by their connections to, and reliance on, major shareholders. A key consideration in an emergency capital raising is whether a company can form a truly independent board committee to negotiate the key agreements and make all key decisions in relation to the capital raising. Properly documenting the functioning of the independent committee is critical.

Need for funds

Regulators will be less likely to intervene if there is a genuine need for the funds being raised. Companies need to be able to prove that the quantum being raised on an emergency basis is not in excess of what is required or a takeover by stealth.

Underwriters and Sub-underwriters

Underwriters are likely to subscribe for a substantial shortfall. Major shareholders who act as underwriters or sub-underwriters will likely increase their voting power substantially – and can do so only under strict compliance with exemptions to Australian Takeovers Laws and policy.

Underwriting Agreements can be related party transactions requiring shareholder approval. Plain vanilla underwriting agreements are more likely to fall within accepted exceptions to these conflict laws governed by Chapter 2E of the *Corporations Act 2001* (Cth) and ASX Listing Rule 10. However, non-standard clauses in favour of the underwriter will be problematic.

Certain underwriters may need an Australian Financial Services Licence – even major shareholders. Underwriting is a "financial service" under the Corporations Act. Whilst some major shareholders will not require an AFSL because they do not "carry on a financial services business", others may be caught by this requirement.

Alternative Transactions

The possibility of the company achieving its goals without a substantial voting power increase of a major shareholder will be a major determinant of whether the capital raising structure is appropriate.

Can the board show ASX, ASIC or the Takeovers Panel it has genuinely taken all reasonable steps to explore alternative transactions and pursue any desirable alternative transactions before it proceeds with the capital raising? In particular, can it show that there are no alternative transactions available that have less of a control impact? Have financial advisers been engaged to assist to find alternative transactions or underwriters?

Are alternatives available under Australian insolvency laws (including safe harbour provisions) that would lead to a better outcome for the company?

Dispersion Strategies

Are there sufficient strategies in place to give other investors (particularly minorities) an opportunity to participate in the shortfall – and lessen the control enhancement of the major shareholder?

Is the offering renounceable? Can shareholders participate in a shortfall facility? Is there a shortfall bookbuild? Is the period of time to participate in the offer reasonable in the circumstances?

Foreign Investors

Many companies will be allowed to exclude foreign investors from accelerated rights and entitlements offers. However, some companies may need the support of foreign shareholders and will need to include them. The recent announcement regarding FIRB approval thresholds now being changed to $0, will now make large foreign shareholders' participation in emergency offerings more difficult for many companies.

Disclosure

ASX and shareholder disclosure must comply with ASX Listing Rule 3.1, with ASIC Policy, with Takeovers Panel Guidance and Corporations Act "cleansing statement" requirements.

It is important that the market not be surprised when an emergency capital raising is announced. Many companies have therefore already made announcements regarding the potential impact of the COVID-19 pandemic on their businesses. A surprise may raise the question whether the market was properly informed in the lead up to capital raising announcement and compliance with Listing Rule 3.1.

To meet "cleansing statement" requirements, companies must consider whether all of their disclosures in recent years, in aggregate, continue to meet test in the Corporations Act that the disclosure contains information that investors and their professional advisers would reasonably require for the purpose of making an informed assessment of ***"the assets an liabilities, financial position and performance, profits and losses and prospects"*** of the company. With the dramatic changes in the economy of recent weeks, a company may need to make substantial financial and business disclosures in a "cleansing statement" at the time of the emergency capital raising.

The intentions of major shareholder underwriters must be properly disclosed. Even though it is the issuer company that is required to make the disclosure, it may not be good enough to simply make boilerplate disclosures about the intentions of the major shareholder underwriter that is increasing its control of the company.

Piper Alderman's Corporate and Securities Team

The Piper Alderman team is at the leading edge of the law and strategy around emergency capital raising and can guide:

- directors;
- independent board committees;
- underwriters;
- participating major shareholders; and
- non-participating shareholders.

Piper Alderman has comprehensive and current insight into the risks and defences connected to capital raising and is experienced in dealing with class actions and litigation funders.