



MEMO

To: Board of Directors
From: Company Secretary
Subject: **RIGHTS ISSUE – SHARES**

A common way for a company to raise additional capital is to approach all shareholders seeking their investment in new shares on a basis pro-rata (ie, in proportion) to their existing shareholdings; this is known as a “rights issue”.

For a company with shareholder pre-emptive provisions in its Constitution (or a Shareholder Agreement) this can also be a way of ‘circumventing’ such constraints (which otherwise might be administratively difficult to manage). A rights issue would not normally require shareholder approval and for a stock exchange listed company, where such approval is required if issuing more than 15% of its existing share capital base, there is a Listing Rule exemption for rights issues (L/R 7.2 Exception 1).

Renounceable or non-renounceable rights

A rights issue may be renounceable or non-renounceable. If renounceable the shareholder has the ability to sell or otherwise transfer his entitlement to another person, whether or not an existing shareholder. However, most listed company rights issues are non-renounceable because of the additional complexity and cost of having the rights quoted on the ASX so they can be traded.

For an unlisted company – where there is no established market to trade the company’s securities – a rights issue would normally be non-renounceable.

Prospectus

Normally a rights issue will require the company to issue a prospectus as there is no specific Corporations Act exemption in such case. However, where there are not many shareholders, a company can take advantage of the Section 708 exemptions [from requiring a prospectus] either under the ‘12/20 rule’ – ie, accepting share applications from up to 20 investors over a 12 month period for a maximum \$2m – or one of the professional or sophisticated investor categories.



Rights offer without prospectus

On the other hand, a listed company has alternatives. It may use a 'short form' prospectus (pursuant to Section 713) or undertake the rights issue without a prospectus provided it issues a 'cleansing notice' – following the procedures in Section 708AA.

The principal advantage for listed company issuers is the time/cost savings/convenience generally gained by not having to prepare a formal prospectus (and undertake the underlying, traditional, due diligence/sign off processes). However, this procedure will still involve documentation assembly and some due diligence (including verification). Also, there is one important disadvantage for an issuer (and its directors and underwriters) in that the statutory due diligence defences (available under Sections 728 & 729) which can protect against liability for offering securities under a 'defective' prospectus do not apply to defects in the documents used when offering rights without a prospectus. So, if there is a misleading or deceptive statement in, or omission from, the documents or cleansing notice, there are no statutory due diligence defences to turn to.

Procedure

The normal procedure for a rights issue is:

1. Formal resolution of the board (could be by conference phone board meeting or Circulating Resolution in need) to proceed with a capital raise on the basis of _____ shares for each _____ held at a price of \$_____ per share. Shareholder rights entitlement determination date and offer close date must also be decided.
2. The board should also decide if the issue is to be renounceable or non-renounceable and/or whether the issue will be underwritten (I would think this should be mentioned in the letter too so shareholders know what will happen if they do not contribute).
3. Prepare and despatch the offer/entitlement letter. The offer letter should at least explain the purpose of the issue and must state each shareholder's entitlement and the date up until which applications will be accepted – but I can find no provision in the Act restricting this to a certain period (although, as with a prospectus, I would suggest 13 months would be the maximum time, otherwise the information in the offer letter could be well out of date – or at least deemed to be so by ASIC). An application form should accompany the letter.



Obviously, if a prospectus is necessary then the relevant information as required under the Act will be contained in that document – which, of course, will be far more than what might be covered in a simple offer letter where the raising is under the Act's fund-raising exemptions.

4. Following receipt of applications and formal closure of the rights issue new shares are then allotted (again, by board resolution), the Share Register is updated and Share Certificates (or Holding Statements if uncertificated) despatched to shareholders. Also, Form 484 must be lodged with ASIC to update their records.

DISCLAIMER

The comments in this memo reflect some commercial aspects and observations on the matter experienced or observed by the writer in practice as he understands them. The information is given as a guide only and does not represent a definitive or legal view of any of the issues raised, covered or referred to and the reader is urged to seek his own professional advice on all aspects of, or pertaining to, this and any related matter.