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Imitation Food In An Imitation Kitchen by Laura Oczosty

RIGHTS AND WRONGS OF RIGHTS ISSUE STRUCTURING

Takeovers panel decisions shed new light on what's acceptable - and what's not.

ASX-listed entities considering rights issues or other secondary equity raising structures should assess potential control effects as part of their preparations. Depending on the size of the raising, the extent of participation of material shareholders and other factors, an ASX-listed entity can find a raising results in a person (or a number of persons) obtaining a significantly increased proportionate shareholding. The dilutive effects and circumstances can potentially enliven complaints from minority shareholders and ASIC.

Two recent Takeovers Panel decisions consider rights issues with material control effects. Both involved renounceable pro rata offers at a material discount. Both involved a shortfall facility. Yet only one gave rise to unacceptable circumstances. The other did not even warrant conducting proceedings. We look at the reasons why and reflect on lessons learned for rights issue structuring.

BACKGROUND

In February 2025, the Panel declared unacceptable circumstances in relation to the affairs of Alara Resources Limited (**Alara**). Alara had announced a $15.3 million renounceable rights issue, at a 31% discount to the last trading price.[1] The offer was sub-underwritten by Alara's largest shareholder, Al Tasnim Infrastructure LLC (**ATI**), enabling it to potentially increase its stake from 14% to 45%.[2]

In comparison, despite multiple applications, the Panel declined to conduct proceedings in relation to the affairs of Energy Resources of Australia Limited (ERA). ERA had announced an $880 million renounceable entitlement offer, at an 88% discount to 5-day VWAP. The offer was not underwritten, but Rio Tinto Limited (**Rio**), ERA's majority shareholder, provided a binding pre-commitment to take up approximately its pro rata share. This would have enabled Rio to increase its holding from 86% to 99%[3] and proceed to compulsory acquisition.

SO WHAT'S THE LAW? GUIDANCE NOTE 17 - RIGHTS ISSUES

In considering whether a rights issue gives rise to unacceptable circumstances, the Panel looks at the effect of the rights issue against the Eggleston principles in section 602.[4] A rights issue resulting in a control effect will generally not be unacceptable if:

- there is a clear need for funds,
- the rights issue is structured appropriately, and
- an appropriate dispersion strategy has been put in place.[5]

1. The Alara offer also involved one free option being granted for every two new shares subscribed, with an exercise price of $0.05 and a term of two years. This was found to increase the control potential of the rights issue because it would allow ATI to 'bank' creep by exercising its options in tranches, in reliance on the 3% creep exception. See *Alara Resources Limited* [2025] ATP 1, [7], [49].
2. Rounded to the nearest whole number – *Alara Resources Limited* [2025] ATP 1, [8](e). The control effect in the Alara raise was exacerbated by the fact that around 51% of Alara shares were held by ineligible foreign shareholders, which was an additional factor weighing in favour of unacceptability – see *Alara Resources Limited* [2025] ATP 1, [6], [51]-[53].
3. Rounded to the nearest whole number, assuming no other shareholders participate in the offer, and any shortfall is not taken up – *Energy Resources of Australia Limited* [2024] ATP 22, [21].
4. Guidance Note 17 - Rights Issues (**GN 17**), [6].
5. GN 17, [10].

WHAT WAS DIFFERENT IN THE ERA AND ALARA CASES?

The control effect of the ERA raise was arguably more severe than the control effect of the Alara transaction. So, what was different, and why did the Panel find unacceptable circumstances for Alara and not for ERA?

a. No clear need for funds

In the Alara decision, the Panel found that there was insufficient material to establish a clear need for all of the funds sought to be raised.[6]

Alara also did not demonstrate an urgent need for all of those funds that would justify the potential control effect of the rights issue.

In contrast, the Panel found that ERA had a genuine need for funds. This was despite the offer being sized at $880 million when only a minimum $210 million was sought originally. In coming to this decision, the Panel noted that ERA's Independent Board Committee (**IBC**) relied on external financial advice to conclude that a single larger raising would be more efficient by minimising costs which would be duplicative across multiple raisings, and reducing the overall amount raised due to interest accrual on the funds raised. The Panel accepted that separate raisings would have involved additional costs and risks, with doubtful success in the absence of investor support.

b. No proper exploration of fundraising alternatives

In the Alara decision, the Panel found that there was insufficient material to show proper exploration of fundraising alternatives. The supporting documents provided by Alara included term sheets received from two PE institutions which were on commercially unattractive terms. The Panel was not persuaded that the passive receipt of these term sheets constituted a genuine exploration of alternative funding options. The Panel was particularly concerned by the absence of supporting material showing that Alara actively sought out or engaged with a broader range of potential financiers beyond these term sheets.

In comparison, the Panel found that the ERA IBC had "genuinely explored all other sensible and reasonable fundraising alternatives". This included:

- considering control transactions, equity, debt and asset sales, as well as funding requests to the Commonwealth Government and Rio;
- conducting an extensive market sounding process using three brokers and the IBC's external financial adviser to contact over 90 investors to determine interest in an equity raise; and
- considering privileged legal advice about the likely consequences of placing ERA into voluntary administration and determining that this would not be in the best interests of ERA.

c. Ineffective dispersion strategy

The Alara offer involved a shortfall facility, however any shortfall would first be allocated to ATI so that it would obtain voting power of 19.9%. The Panel found this arrangement reduced the effectiveness of the shortfall facility as a dispersion strategy and was inconsistent with GN 17, contributing to unacceptable circumstances. The effectiveness of Alara's dispersion strategy was also undermined by the fact that it had not considered alternative sub-underwriters to ATI, independently tested the market, or consulted other potential underwriters to validate its views on the prospects of securing support from other investors.

In contrast, the ERA shortfall facility did not have a preferential allocation in favour of Rio (who was restricted from taking up any shortfall under the ASX Listing Rules in any event) Unlike the Alara decision, the Panel found that ERA had incorporated a dispersion strategy in accordance with GN 17.

6. *Alara Resources Limited* [2025] ATP 1, [28]. The Panel's decision on this point reflects a lack of clarity on the overall funding structure and delays by Alara in providing information despite multiple questions and follow-up inquiries from the Panel on the need for funds – see [37].

d. Inadequate management of conflicts of interest

The Panel's decision in Alara reflects its concerns around the disclosure and management of conflicts of interest. A Non-Executive Director of Alara was the Managing Director of ATI and held 34% of the shares in ATI. That Director's alternate was also the Chief Operating Officer of ATI. These conflicts and how they were being managed were not disclosed in the prospectus.

Alara submitted that conflicted directors were excluded from relevant discussions and decisions, and a sub-committee of non-conflicted directors was formed to ensure independence. Alara also provided Board minutes approving the rights issue and a Conflicts of Interest and Duty Policy dated 2018. The Panel considered that these limited materials raised concerns about the robustness and transparency of the processes implemented In the circumstances, the Panel would have expected a more comprehensive suite of supporting materials such as detailed board minutes and papers demonstrating deliberation on the identification and management of conflicts, and records of specific steps taken to mitigate those conflicts.

On the other hand, the Panel found that ERA had taken appropriate measures to ensure the independence of its Independent Board Committee (**IBC**) and manage conflicts of interest through:[7]

- the appointment of independent financial and legal advisers for the IBC;
- the adoption of detailed conflicts protocols in relation to the independence of the IBC and managing conflicts of interest and related party transactions;
- ensuring that the IBC was delegated all the powers, authorities and discretion of the full ERA Board with respect to any transaction or proposal; and
- limiting the involvement of ERA management and employees seconded from Rio to the maximum extent possible.

7. *Energy Resources of Australia Limited 04* [2024] ATP 22, [32]. The Panel also noted that previous decisions (ie *Energy Resources of Australia Limited* [2019] ATP 25 and Energy Resources of Australia Limited 02R [2020] ATP 3) found that the independence of the IBC was potentially compromised due to insufficient measures being taken to ensure the independence of ERA's IBC and potential conflicts of interest were not sufficiently managed.

LESSONS LEARNED

The ERA decision shows that a properly structured capital raise with an effective dispersion strategy and (where applicable) overseen by an IBC can withstand Panel challenge even though there may be potential control impacts. The Panel will usually accept a Board's decision as to the need for funds if the decision appears to be reasonable and supported by rational reasons. Given the ERA IBC took appropriate professional advice and followed appropriate procedures to ensure its independence, the Panel was not minded to second guess the decisions of the IBC regarding the rights issue, including in relation to ERA's need for funds, the size or structure of the rights issue or alternative funding options.

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