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Thursday, 20 January 2005

**RIVKIN FINANCIAL SERVICES LIMITED 02: PANEL MAKES DECLARATION  
OF UNACCEPTABLE CIRCUMSTANCES AND ACCEPTS UNDERTAKINGS**

The Panel announces that it has made a declaration of unacceptable circumstances in response to an application from Network Limited (**Network**) under section 657C of the Corporations Act in relation to the affairs of Rivkin Financial Services Limited (**RFS**). The Panel has accepted undertakings from RFS which address its concerns. The application relates to a 1 for 3 pro-rata renounceable rights issue proposed by RFS, to be fully underwritten by Westchester Financial Services Pty Limited (**Westchester**) and fully sub-underwritten by Central Exchange Limited (**CXL**).

**Summary**

The Panel considered that unacceptable circumstances existed in that:

- RFS is subject to an ongoing contest for control, the current status of which is clouded by uncertainty, due to the conflicting voting patterns of shareholders regarding the composition of the board of RFS as between RFS' EGM and AGM, each of which was held on 29 November 2004;
- the Rights Issue and Underwriting had the capacity to significantly impact that contest for control. There are no genuinely independent members of the board of RFS, and the contest for control could have been determined by the Rights Issue in favour of interests associated with the incumbent directors;
- there was no immediate or compelling need for the Rights Issue, nor any pressing need for it to occur before two proposed shareholder meetings which may remove the uncertainty as to the status of the incumbent board of RFS and the contest for control of RFS. There is no ASX listing requirement to increase RFS' capital at this time and, in the Panel's view, the amount of capital to be raised by the offering would be unlikely to materially change the market's perception of RFS as an investment company;
- the Rights Issue and Underwriting<sup>1</sup> was not in pursuance of a course which had been put before, or approved by, RFS shareholders, notwithstanding that it is likely that shareholder approval will be required for a proposed spin off of RFS' Avcol business;
- there was inadequate disclosure in the Rights Issue prospectus of the potential impact of the Rights Issue on the control of RFS;
- the Rights Issue was announced on 24 December 2004, a time at which many of RFS' approximately 2,400 shareholders may not have made arrangements to receive a rights offer (there having been no earlier indication to the market of

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<sup>1</sup> Although not required under the Corporations Act, shareholder approval of the Rights Issue and the Underwriting would have been a mitigating factor against unacceptable circumstances existing.

the intention to make the Rights Issue) and in the circumstances this militated against the “genuine accessibility” of the issue;

- the pricing of the Rights Issue, in that the discount was at the lower end of discounts that would have encouraged a take-up of Rights or trading in Rights; and
- in all of the above circumstances, the ‘underwriting’ and ‘sub-underwriting’ arrangements may be characterised as a de facto placement to a substantial shareholder with interests aligned with the incumbent board members since, unlike conventional underwriting arrangements, their structure was likely to increase rather than minimise the shortfall in take-up in a situation where the sub-underwriter was not receiving any benefit which could reasonably be seen as offsetting that risk other than increased control over RFS. For instance:
  - RFS retained the right to approve sub-underwriters;
  - CXL offered to sub-underwrite the entire Rights Issue;
  - CXL stipulated that it could terminate any sub-underwriting arrangements if certain other persons were appointed as sub-underwriters (which it was apparent to the Panel would include, at least, Pinnacle and likely Network); and
  - CXL offered to sub-underwrite the Rights Issue for no fee.

The Panel considered that it was the combination of the above elements, rather than any one particular factor - and notwithstanding what might otherwise be regarded as mitigating factors such as the fact that the issue was renounceable and that an offer of sub-underwriting was made to other significant shareholders - that caused unacceptable circumstances to exist in relation to the Rights Issue.

The Panel was concerned that if it permitted the Rights Issue to continue it would be doing so in circumstances which could result in:

- an acquisition of control in RFS taking place in a market which was not efficient, competitive and informed; and
- all shareholders in RFS not having a reasonable and equal opportunity to participate in benefits accruing to holders through a proposal pursuant to which CXL might acquire a substantial interest in RFS, where it was practicable to avoid that inequality of opportunity.

RFS undertook to the Panel that the Rights Issue (and therefore the Underwriting) would not proceed unless the acquisition of relevant interests in the RFS shares pursuant to the Underwriting is first approved under item 7 of section 611 on the basis that each of the following persons are associates of one another: CXL, Sofcom Limited (**Sofcom**), Fastscout Limited (**Fastscout**), Altera Capital Limited (**Altera**), Westchester, and their respective officers, related parties and associates.

RFS also undertook that RFS would not make any rights offer for three months if the rights offer might result in any of the above persons acquiring a relevant interest in shares in RFS pursuant to an underwriting or sub-underwriting arrangement and increasing the collective voting power of the above persons over or further over 20%, unless the acquisition of shares is approved under item 7 of section 611 on the basis

that each of the above persons is to be regarded as an associate of each other for the purposes of the undertaking given by RFS.

The Panel considered that these undertakings remedied the unacceptable circumstances. Accordingly, it was not necessary for the Panel to make final orders in response to the application.

The Panel considers that the undertakings from RFS are the most appropriate means of remedying all of the factors contributing to the unacceptable circumstances outlined above. The Panel is open to the possibility of permitting RFS to vary its undertakings in relation to future rights issues and underwriting arrangements if it is appropriate to do so – for instance, if, before the end of three months, the contest for control of RFS is resolved or RFS has an urgent or compelling need to conduct a fundraising.

## Background

### RFS

The nature of RFS' business is in dispute. Some of its shareholders regard it primarily as a listed investment company, which also owns a stockbroking business (**Avcol**). Others regard it as a stockbroking business with ancillary investments.

### Major shareholders in RFS

Over a series of months, a number of shareholders have acquired or disposed of interests in RFS. As at the record date for two meetings held on 29 November 2004, those shareholders and their shareholdings were as follows:

Shareholder	Shares	Percentage Holding
CXL	14,993,048	14.95%
Pinnacle Asset Management Pty Ltd ( <b>Pinnacle</b> )	10,170,363	10.14%
Network	9,000,000	8.97%
Alan Davis Group Pty Ltd ( <b>ADG</b> )	7,305,784	7.28%
Cole Kablow Superannuation Pty Ltd ( <b>CKS</b> )	3,460,000	3.45%
Sofcom Ltd	3,400,000	3.39%
Fast Scout Ltd	908,471	0.91%
Altera Capital Ltd	750,000	0.75%
Others	50,324,468	50.17%
<b>Total</b>	<b>100,312,134</b>	

Since then, there have been further transactions in RFS shares. As such, the holdings of the following parties (collectively, except for Others, the **Major Shareholders**) are now:

Shareholder	Shares	Percentage Holding
CXL	14,993,048	14.95%
Pinnacle	12,123,049	12.09%
Network	9,000,000	8.97%
ADG	7,305,784	7.28%

CKS	3,460,000	3.45%
Sofcom	3,167,152	3.16%
Fast Scout	846,101	0.84%
Altera	698,718	0.70%
Others	48,718,282	48.57%
<b>Total</b>	<b>100,312,134</b>	

#### The meetings of 29 November 2004

On 29 November 2004, two meetings of shareholders in RFS took place. First, a meeting (the **EGM**) requisitioned by CXL to seek the removal of the then directors of RFS and to replace them with nominees of Sofcom, Fast Scout and Altera (the **Sofcom Group**). Secondly, the annual general meeting (the **AGM**) of RFS. The notice of AGM included resolutions in relation to the election of the pre-EGM board of RFS and the nominees of the Sofcom Group.

At the EGM, the then board of RFS was removed and replaced with nominees of the Sofcom Group, namely Mr Farooq Khan, Mr Christopher Ryan and Mr Simon Cato. In each case, the resolutions to remove the existing directors and to appoint the new directors were passed by margins of between 1.2 – 1.6% of the votes cast.

Fewer proxies were submitted to the AGM than the EGM, so that approximately 10 million fewer votes were exercised at the AGM than the EGM.

At the AGM, Mr Khan (as the newly appointed Chairman) withdrew from consideration of the meeting the resolutions relating to the election of the pre-EGM board of RFS and two of the three nominees of the Sofcom Group. In accordance with the RFS constitution, one of the three newly appointed directors retired at the AGM. Accordingly, Mr Ryan retired and the meeting considered the resolution to elect Mr Ryan. That resolution was defeated. The next day, Mr Ryan was appointed to the board by the then directors, Mr Khan and Mr Cato. Mr William Johnson was also appointed to the RFS board by the post-AGM directors, and Mr Victor Ho was appointed as the company secretary of RFS.

The Panel received details of the proxies which were lodged in relation to the withdrawn resolutions. On the basis of that proxy information, the Panel considers it probable that, if the Board had been constituted on the basis of the resolutions included in the Notice of the AGM, the Board of RFS would have comprised the three pre-EGM directors of RFS.

#### Notice of intention to requisition further meetings (**Spill Meetings**)

On 2 December 2004, Pinnacle announced its intention to call a general meeting of RFS pursuant to section 249F of the Corporations Act to remove all of the existing directors of RFS and to appoint 4 nominees of Pinnacle.

On 6 December 2004, Network announced its intention to call a general meeting under section 249F of the Corporations Act to remove all of the existing directors of RFS and to appoint nominees of Network.

While there has been no notice of meeting provided to RFS shareholders by either Pinnacle or Network since early December 2004, each has indicated to the Panel that they intend to convene the meetings for mid-February 2005.

### The Rights Issue

On 22 December 2004, RFS shares were placed in a pre-open trading halt at the request of RFS.

On 24 December, RFS announced a 1 for 3 renounceable rights issue (**Rights Issue**) and a proposal to “spin off” its Avcol stockbroking business. The Rights Issue was intended to raise approximately \$6.7 million, was to be underwritten by Westchester and fully sub-underwritten by CXL. The issue was priced at 20 cents per new share, being a discount of 10% to the closing market price one day before the execution of the underwriting agreement.

That day, RFS lodged a prospectus with ASIC in relation to the Rights Issue. On 29 December 2004, the prospectus was lodged with ASX.

In accordance with the minimum timetable for the conduct of a rights issue contemplated by the ASX Listing Rules, trading in the rights under the Rights Issue was scheduled to commence on 5 January 2005 and conclude on 19 January 2005, with the Rights Issue to close on 27 January 2005.

### The Underwriting

Between 8 December 2004 and 20 December 2004, RFS sought proposals from four parties in relation to underwriting the Rights Issue. It is apparent from the three formal underwriting proposals received that RFS stipulated that the underwriters would be required to formally approach the Major Shareholders with a view to them sub-underwriting the issue. The three underwriters in question were DJ Carmichael Pty Ltd, Cameron Stockbrokers Limited and Westchester. The sole director and secretary of Westchester is Mr Christopher Ryan.

Ultimately, RFS determined to proceed with Westchester as the underwriter. Westchester’s offer was conditional on it being able to obtain sub-underwriting commitments for 100% of the issue. It offered to underwrite the issue for \$15,000 plus GST and any sub-underwriting fees (up to a cap of 3.5% of the amount to be sub-underwritten).

On 20 December 2004, Westchester wrote identical letters to each of the Major Shareholders inviting them to offer to sub-underwrite the Rights Issue. Major Shareholders were given until 5pm on 22 December 2004 to make sub-underwriting offers. Westchester required that such offers remain open until 5pm on 31 December 2004.

CXL was the only Major Shareholder to offer to sub-underwrite the Rights Issue. Pinnacle, Network and ADG both responded by protesting to either Westchester or RFS about the approach and/or about the fact that the Rights Issue was being pursued at all.

Although CXL might only have received formal notice of the sub-underwriting opportunity on 20 December 2004, the Panel considers that it is reasonable to infer that CXL knew about it considerably before then because two of its officeholders, Mr William Johnson and Mr Victor Ho, were present at a RFS strategic review board meeting over 6 to 8 December 2004 at which it was discussed and endorsed, and that they therefore should be presumed to have known by 8 December 2004 the details of

the Rights Issue, in particular that Major Shareholders, including CXL, would be approached in relation to sub-underwriting it.

CXL offered to fully sub-underwrite the offer for no fee. CXL reserved the right to withdraw from its sub-underwriting position if 'IWL or any party which CXL regarded as being associated with IWL' was granted a sub-underwriting position (Pinnacle is a subsidiary of IWL). CXL sought to justify this position on the basis of a concern that if IWL increased its shareholding in RFS materially above its current level of 12%, this would have a destabilizing effect on the value of CXL's substantial investment in RFS. Interestingly, CXL did not seek a termination right if IWL bought shares on market – only if they participated in the sub-underwriting.

On 23 December 2004, Westchester and RFS entered into an Underwriting Agreement, and CXL and Westchester entered into a Deed of Sub-underwriting, to record the underwriting arrangements outlined above (**Underwriting**).

#### Effect of the Rights Issue and Underwriting on Control of RFS

The following table sets out the voting power exercisable by CXL in its own right and the collective voting power which would be exercisable by two groups of Major Shareholders following the Rights Issue under various scenarios. Each scenario assumes that no shareholder other than a Major Shareholder participates. The sensitivities examined are whether the Underwriting also proceeds and which Major Shareholders participate. The Panel has grouped the respective voting power of the Major Shareholders on the basis of its understanding as to how they voted at the EGM and the AGM. However, the information presented is based on the holdings of shareholders at the date of the prospectus for the Rights Issue.

**Table 1: Potential Impacts of Rights Issue and Underwriting**

	<b>CXL</b>	<b>CXL and Sofcom Group</b>	<b>Pinnacle, Network, ADG, CKS</b>
<b>Present Voting Power</b>	14.95%	19.64%	31.79%
<b>Post Rights Issue, no Underwriting, only CXL takes up Rights</b>	18.98%	23.46%	30.28%
<b>Post Rights Issue, with Underwriting, only CXL takes up Rights</b>	36.21%	39.73%	23.84%
<b>Post Rights Issue, no Underwriting, only CXL and Sofcom Group takes up Rights</b>	18.70%	24.58%	29.84%
<b>Post Rights Issue, with Underwriting, only CXL and Sofcom Group takes up Rights</b>	35.50%	39.73%	23.84%
<b>Post Rights Issue, no</b>	17.01%	22.36%	36.18%

<b>Underwriting, all Major Shareholders take up Rights</b>			
<b>Post Rights Issue, with Underwriting, all Major Shareholders take up Rights</b>	27.09%	31.79%	31.79%

### **Interim Orders**

The Panel issued interim orders on 5 January 2005 postponing the commencement of Rights trading until 14 January 2005. On 13 January 2005, the Panel issued further interim orders requiring the record date for the Rights Issue to be no earlier than 7 business days after the date on which the Panel's proceedings were determined. The effect of the Panel's further interim orders was that Rights trading could not commence before the Panel's proceedings were determined.

The Panel was concerned to ensure that Rights trading did not occur in circumstances where, due to the Panel's ongoing proceedings, there continued to be uncertainty as to whether the Rights Issue would proceed or the terms on which it would proceed.

### **Court proceedings**

After Network made its application to the Panel, Pinnacle initiated proceedings against RFS in the Supreme Court of Victoria seeking to prevent the Rights Issue proceeding. Although both the Panel proceedings and the Court proceedings related to the Rights Issue and the Underwriting, the basis on which Pinnacle sought to challenge the Rights Issue in the Court proceedings was different to the basis on which Network sought to challenge the Rights Issue in the Panel proceedings. The Panel did not consider that there was any reason to defer its own consideration of the Application by reason of the Court proceedings.

### **Relationship between Network and Pinnacle**

During the course of proceedings, CXL and RFS alleged that Network and Pinnacle were associates and that, accordingly, they had breached the Corporations Act. The Panel did not deliberate on the merits of this allegation. The Panel considered that it was not germane to the present application. To the extent that the parties wished the Panel to consider this issue, it would more appropriately be the subject of a separate application. No such application has been made.

### **Relationship between CXL, Sofcom, Altera, Fast Scout and RFS**

There is considerable overlap between the officeholders of RFS, CXL, Sofcom, Altera and Fast Scout, as well as Queste Communications Limited (which is the controlling shareholder in CXL).

RFS	William Johnson (Director) Farooq Khan (Director) Christopher Ryan (Director)
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	Simon Cato (Director) Victor Ho (Company Secretary)
CXL	William Johnson (Director) Victor Ho (Director and Company Secretary) Yaqoob Khan (Director)*
Sofcom	Farooq Khan (Director) Victor Ho (Director and Company Secretary) Simon Cato (Director)
Fastscout	Farooq Khan (Director) Yaqoob Khan (Director)* Victor Ho (Director and Company Secretary) Azhar Chaudri (Director)
Altera	Farooq Khan (Director) Victor Ho (Director and Company Secretary) Simon Cato (Director)
Queste Communications Limited	Farooq Khan (Director) Yaqoob Khan (Director)* Azhar Chaudhri (Director) Michael van Rens (Director) Victor Ho (Company Secretary)

\* Yaqoob Khan is the brother of Farooq Khan.

The Panel did not consider it necessary to resolve whether one or more of the above parties were technically 'associates' within the meaning of the Corporations Act.

The Panel noted:

- the overlap in officeholders of these companies and the relationship between the officeholders;
- Mr Khan gave evidence in the proceedings before the Federal Court that he was responsible for making investment decisions for the Sofcom Group;
- Mr Khan has a relevant interest in shares held by CXL<sup>2</sup>;
- in proceedings against the Sofcom Group in the Federal Court of Australia, Emmett J found that "the controlling mind and will of each of the Khan Companies [the Sofcom Group] was constituted by the mind of Mr Khan"; and
- CXL and the Sofcom Group had previously been party to an agreement under which they agreed to co-operate in relation to their shareholdings in RFS (although ASX was advised that that agreement was terminated on 16 December).

In light of the above, irrespective of whether CXL, Sofcom, Fast Scout and Altera were collectively 'associates' within the meaning of the Corporations Act, the Panel determined that it was necessary in the interests of an efficient, competitive and informed market for the control of RFS for shareholders (and potential shareholders

<sup>2</sup> ASX Appendix 3Y notice lodged by Mr Khan dated 20 December 2004.

pursuant to renounced rights) to be informed of the maximum voting power which those entities might collectively exercise following completion of the Rights Issue. The prospectus for the Rights Issue disclosed only the maximum voting power which Central Exchange Limited might have on the basis of shares held directly by it. In considering this issue and the material before it, the Panel formed the view that Mr Farooq Khan has a relevant interest in all of the RFS shares held by each of CXL and the Sofcom Group.

Also in light of the above, the Panel was particularly conscious that the RFS board was comprised only of representatives or nominees of CXL and the Sofcom Group in circumstances where the collective voting power of CXL and the Sofcom Group might potentially increase significantly pursuant to the Rights Issue and in circumstances where neither the Rights Issue nor Underwriting had been approved by shareholders.

### **Effect of the Rights Issue and Underwriting on control**

It is apparent that the contest for control of the RFS board is finely balanced.

It is equally apparent that the Rights Issue and, in particular, the Underwriting have the capacity to have a significant impact on the control of RFS. This is illustrated in Table 1.

### **Ongoing contest for control**

Network argued that it comprised unacceptable circumstances for the RFS board to pursue the Rights Issue and Underwriting because, given that it had received notice of the two Spill Meetings, it was acting in a 'caretaker capacity'. In *BigShop.com.au Limited 01* and *02*, the sitting Panels were not prepared to accept that any caretaker director doctrine applied in a case where a 12.59% shareholder had requisitioned a meeting. The Panels in those matters considered that this would risk undue restriction on directors. In the current proceedings, the Panel saw no reason to depart from this position merely because two shareholders with aggregate holdings of 21.06% had requisitioned two meetings.

However, the circumstances of 29 November 2004 are shrouded in confusion. It is not at all clear whether the RFS board would comprise the current directors if the motions withdrawn from consideration at the AGM had been put to the AGM.

In those circumstances, the Panel considers that it was incumbent on the RFS board to have taken *all reasonable steps* to structure any transaction which it undertook in such a way as not to have any material impact on the contest for control of RFS and, if it was unable or did not wish to do so, to obtain shareholder approval for the transaction. The Panel does not consider that the results of the EGM and AGM can in any way be considered a *de facto* approval for such a transaction: not only would the uncertainty clouding the result of the EGM and AGM also cloud any implied shareholder approval, but the prospect of a Rights Issue and related party underwriting was not raised with shareholders in the explanatory material for those meetings<sup>3</sup> or at the meetings. In this regard, the Panel was informed by RFS that the

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<sup>3</sup> The Sofcom Group's "statement from members" at the EGM did not contain any reference to any plans to raise capital by means of an underwritten rights issue or otherwise – there was only a general statement about seeking to "grow RFS".

decision to proceed with a Rights Issue had been made after the EGM and AGM and following a three-day examination by the new RFS board between 6 December 2004 and 8 December 2004 of strategic options for the company (that is, little over a week after the EGM and AGM).

The Panel was also mindful that the timing of and timetable for the Rights Issue was such that, collectively, CXL and the Sofcom Group would benefit from any increased voting power which they enjoyed pursuant to the Rights Issue and Underwriting at the proposed Spill Meetings.

### **Absence of a compelling need for funds**

The requirements of reasonableness in the context of the 'reasonable steps' referred to above will vary according to the extent to which the company needs to undertake the corporate transaction in question: for instance, because the company has an urgent or compelling need to conduct a fundraising.

The Panel did not accept that RFS had an urgent or compelling need to conduct the Rights Issue. RFS asserted that the purpose of the fundraising was essentially to improve the company's position in the market as a listed investment company by increasing its asset base (which would, for instance, reduce its management expense ratio and improve its ability to diversify its investments). In this regard, RFS pointed to the fact that a listed investment company would only be admitted to the official list of the ASX if its investment asset base was at least \$15 million and that, unless the Rights Issue and Underwriting both proceeded, RFS could not be assured of having such an asset base.

The Panel notes that this requirement for a minimum asset base only applies to companies seeking to be admitted to the official list of ASX and that ASX will not, in the ordinary course, seek to remove a company from the official list in circumstances where it does not continue to satisfy this initial listing requirement. RFS acknowledged that it was not subject to any formal requirement to maintain an asset base at this level, and the Panel did not receive any indication that RFS was at risk of being removed from the official list if the Rights Issue and Underwriting did not proceed.

While the Panel recognises that it might be desirable for RFS to increase its asset base and reduce its management expense ratio, it does not accept that this needs to be done urgently. Also, based on its collective experience and market knowledge, the Panel is not convinced that there will be any material difference to RFS' position if the Rights Issue is completed relative to its position if it is not completed. A material change in RFS' position in the market would require RFS to raise a considerably larger amount of money.

### **Structure of the Rights Issue**

Subject to concerns in relation to timing (which are discussed below), the Panel accepted that the Rights Issue complied with the technical requirements of Item 10 of section 611 such that, prima facie, that exception would apply to exempt any acquisition of a relevant interest under the Rights Issue and associated underwriting arrangements which would otherwise constitute a breach of section 606.

The Panel has, however, previously recognized that where a Rights Issue is not “genuinely accessible”, unacceptable circumstances may exist notwithstanding technical compliance with Item 10 of section 611. In this regard, the Panel was concerned that the following factors (taken together) made the Rights Issue less accessible to shareholders and therefore made a shortfall under the Rights Issue more likely.

#### Discount

The Panel considered the trading history in RFS shares, in particular the volatility of its share price and the volatility of volumes traded. The Panel also considered the nature of RFS’ business, the size of its share register and the end of the market in which it operated. Having regard to these factors, the Panel was concerned that the discount for the Rights Issue was at the bottom end of the range of discounts which would have encouraged a take-up of Rights or trading in Rights. In this regard, the Panel was conscious that RFS did not seek external advice on the appropriate discount.

#### Renounceability

The Panel welcomed the decision to make the Rights Issue renounceable. At the same time, the Panel recognised that the small discount and the proposed timing of the issue meant that it was unlikely that there would be a significant market for the Rights.

The Panel noted that some Major Shareholders would be constrained in their ability to purchase and exercise rights on market due to section 606 (as opposed to CXL which would have the benefit of the underwriting exceptions). At the same time, the Panel recognised that those Major Shareholders were offered the opportunity to sub-underwrite the offer (and thus acquire shares in a manner exempt from section 606). However, these sub-underwriting offers did not outweigh the Panel’s other concerns about the circumstances surrounding the Rights Issue and Underwriting.

#### Timing

The Panel was concerned that the issue had not been announced prior to 24 December and that the period over which the Rights Issue was to be conducted, namely the Christmas and January period, was a period during which it was reasonable to expect that, due to absence through holiday and leave, some RFS shareholders would have less time to consider properly the proposed transaction under the Rights Issue. This would further restrict the accessibility of the Rights Issue to shareholders in general, and was likely to result in an increased shortfall.

This concern was reinforced by the fact that, given RFS’ position in the market, the Rights Issue received (and was always likely to receive) little press coverage – particularly, during the Christmas and New Year period, and RFS’ own observation that it had sought to announce the Rights Issue before Christmas because its board was going on leave over the Christmas-New Year period.

In considering RFS’ submissions regarding the reasons for conducting the Rights Issue over this period, the Panel noted that the RFS Board did not obtain independent financial advice regarding the timing, or other aspects, of the Rights Issue.

It follows from the Panel's conclusion that RFS did not have a compelling need for the funds proposed to be raised that the Panel could see no acceptable reason why it was necessary to conduct the Rights Issue over this period. That is, the Panel could see no acceptable reason for the accessibility of the Rights Issue being reduced in this way.

### **Underwriting Arrangements**

The Corporations Act contains two exceptions relating to underwriting. One (contained in item 10 of section 611) relates specifically to increases in voting power as a result of a qualifying rights issue and extends to any associated underwriting or sub-underwriting arrangements (the **Item 10 Exception**). The second (contained in item 13 of section 611) relates specifically to increases in voting power as a result of underwriting or sub-underwriting arrangements (the **Item 13 Exception**).

In each case, the increase in voting power must result from underwriting or sub-underwriting arrangements. The Panel will consider unacceptable circumstances to exist where the increase in voting power results from arrangements which although described as underwriting arrangements are, in fact, better characterised as something else, such as placement arrangements.

The essence of underwriting arrangements is that a person bears the risk of a shortfall in return for valuable consideration. It will generally be inconsistent with the nature of underwriting for the underwriter to agree to arrangements which unduly or unnecessarily increase the risk of a shortfall – so that, in effect, their risk becomes that shareholders will participate in the underlying issue.

In this case, the Underwriting is not a conventional combination of underwriting and sub-underwriting on ordinary commercial terms. In the Panel's view, the proposed 'underwriting' and 'sub-underwriting' arrangements, when looked at in combination with the accompanying Rights Issue, are not properly characterised as underwriting arrangements. Rather they may more appropriately be characterised as having the likely effect of placing shares with a particular party. The Panel has had regard to the following factors:

- The timing of the Rights Issue over the Christmas-New Year period. Given that the first announcement of the Rights Issue was on 24 December, this was likely to increase substantially the shortfall under the Rights Issue.
- RFS had no compelling need for the additional funds to be raised under the Rights Issue. By definition, therefore, there was not actually a need for the underwriting and sub-underwriting arrangements at that time.
- Although RFS approached three underwriters, in each case it stipulated that CXL must be approached (as well as the other Major Shareholders). Accordingly, the process in relation to the underwriting was such as to ensure that CXL would always be able to put forward its proposal.
- RFS reserved the right to veto sub-underwriters;
- The structure of the CXL underwriting proposal tended to ensure that any shortfall would fall to it, but without any compensating benefit in the form of an underwriting fee. In this regard, CXL effectively put Westchester in the position where it would have no choice but to select CXL (or CXL in

conjunction with a member of the Sofcom Group) as sole underwriter(s) because:

- CXL stipulated that it could terminate the arrangements if any of IWL or persons whom CXL regards as IWL's associates were appointed as sub-underwriters (and it is apparent to the Panel that CXL would likely regard at least Network as an associate of Pinnacle); and
  - CXL stipulated that it would underwrite the issue for no fee, and it is reasonable to infer that no other person would have offered "sub-underwriting" services on such an uncommercial basis.
- The ordinary course of CXL's business did not appear to include underwriting activities in the nature or magnitude of its sub-underwriting of the Rights Issue.
  - Despite the fact that CXL was prepared to underwrite the issue for no fee, it was clearly prepared to subscribe for any shortfall at a modest discount (see further the Panel's analysis as to discount above). In other words, the only material benefit which CXL would obtain in exchange for the 'risk' of subscribing for further shares was that, in addition to its Rights, it would have an opportunity to acquire new RFS shares (including above the 20% limit imposed by section 606) at close to their market value.
  - The invitations to sub-underwriters did not provide them with a reasonable period of time to consider the proposal, having regard to the ongoing contest for control and the Panel's inference that officeholders of CXL had advance notice of the Rights Issue proposal (through a common director and, in all likelihood, the common company secretary) and the prospect of underwriting offers.

In this regard, the Panel noted that although CXL may not have been formally offered the opportunity to sub-underwrite the Rights Issue until 20 December 2004, Mr Johnson and Mr Ho, who are both officers of CXL and also officers of RFS, were present at the RFS strategic review board meeting over 6 to 8 December 2004 and should be presumed to have known by 8 December 2004 the details of the Rights Issue, in particular that Major Shareholders, including CXL, would be approached in relation to the Rights Issue.

- RFS was aware that, given the hostility between CXL and the Sofcom Group (on the one hand) and the other Major Shareholders (on the other hand) any approach to sub-underwrite the Rights Issue was likely to result in a hostile response.

The Panel also notes that the underwriting arrangements were not in furtherance of any specific proposal previously put to shareholders and cannot in any way be said to have been specifically sanctioned by shareholders.

The Panel accepts that a company or underwriter may, in many circumstances, properly and sensibly approach major shareholders to sub-underwrite an issue as a legitimate means of securing financial support for a capital raising. However, in such circumstances, where a board may expect any shareholder willing to sub-underwrite to retain any shortfall allocation they receive, the board must make every effort to ensure that the underwriting process provides as equal an opportunity as possible

for shareholders to participate or obtain shareholder approval for the underwriting arrangements. To do otherwise is inconsistent with equal opportunity principle in section 602(c).

### **Undertakings**

The Panel considered a range of options which might remedy the unacceptable circumstances.

Some elements of the unacceptable circumstances might have been able to be rectified by specific undertakings or orders. For instance, concerns relating to the timing of the Rights Issue in the Christmas-January period would have been able to be addressed by undertakings or orders relating to the timetable of the Rights Issue (if they had not already been addressed by the interim orders). And that aspect of the unacceptable circumstances relating to the failure to disclose adequately the potential effects of the Rights Issue on the collective voting power of CXL and the Sofcom Group might have been resolved by an undertaking that RFS would issue, or an order requiring RFS to issue, a replacement prospectus for the Rights Issue.

RFS did offer to issue a supplementary prospectus, however, the Panel decided that disclosure alone would not adequately remedy the unacceptable circumstances. The Panel considered that in order to address the totality of the unacceptable circumstances, the most appropriate undertakings or orders would require RFS shareholder approval of the Underwriting, in order for the Rights Issue and Underwriting to proceed. On 18 January 2005, RFS offered and the Panel accepted such undertakings. Having regard to the Panel's view that the Underwriting, as currently structured and on the process gone through, might better be characterised as a placement, the appropriate shareholder approval regime for the Underwriting is that set out in item 7 of section 611. Given the Panel's concerns as to the relationships between CXL, Westchester, the Sofcom Group and their officers and related companies, those entities will be considered associates for the purposes of any such shareholder approval of the Underwriting.

The Panel has also accepted undertakings to the effect that RFS will obtain shareholder approval before RFS makes any further rights offer in the next three months, if the rights offer might result in any of CXL, Westchester, the Sofcom Group and their officers, associates and related parties increasing their collective voting power in RFS over or further over 20% pursuant to underwriting or sub-underwriting arrangements. While there is still considerable uncertainty as to the contest for control of RFS, there should, in general, not be any transaction which might be better characterised as a placement which might have a significant impact on that contest and which has not been sanctioned appropriately by shareholders. Any such transaction would most likely involve underwriting arrangements and hence the Panel has accepted undertakings from RFS which relate to underwriting arrangements which might be proposed over the next three months. It remains possible that another type of transaction with control consequences might be proposed, and the Panel has expressly noted that it is not limiting its ability or the ability of any future Panel to declare that unacceptable circumstances exist, accept undertakings and make orders in relation to any such other type of transaction.

The Panel accepted undertakings in relation to a three month period as the Panel considered that the contest for control of RFS would be likely to be resolved in that

period and, if not, that at least the confusion surrounding the status of the contest was likely to be resolved. The Panel will be prepared to consider agreeing to RFS varying its undertakings so that they cease to apply earlier than the conclusion of three months if the contest for control (or the attendant confusion) is resolved before then. The Panel will also be prepared to consider agreeing to RFS varying its undertakings if RFS proposes an underwriting which the Panel is satisfied does not comprise unacceptable circumstances.

Copies of the declaration of unacceptable circumstances and RFS' undertakings are attached to this media release.

The President of the Panel appointed Simon McKeon, Kathleen Farrell and Graham Bradley to constitute the sitting Panel to consider the application.

In due course, the Panel will publish on its website its reasons for its decision in these proceedings.

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## Annexure A

### Declaration of Unacceptable Circumstances

#### In the matter of Rivkin Financial Services Limited 02

#### WHEREAS

- A. Rivkin Financial Services Limited (**RFS**) is subject to an ongoing contest for control, the current status of which is clouded by uncertainty following two shareholder meetings on 29 November 2004;
- B. RFS has proposed a 1 for 3 pro-rata renounceable rights issue (the **Rights Issue**) to be conducted pursuant to a prospectus dated 24 December 2004 and which is fully underwritten by Westchester Financial Services Pty Limited (**Westchester**) and fully sub-underwritten by Central Exchange Limited (**CXL**) (the combination of the underwriting and sub-underwriting arrangements being referred to in this Declaration as the **Underwriting**);
- C. CXL owns 14.95% of the shares in RFS and companies connected with CXL (namely Sofcom Limited, Altera Capital Limited and Fast Scout Limited (the **Sofcom Group**)) own a further 4.70% of the shares in RFS between them;
- D. the board of RFS does not contain directors who are genuinely independent of CXL and the Sofcom Group;
- E. the Rights Issue and Underwriting have the capacity to impact the contest for control of RFS significantly in that, potentially, the collective voting power of CXL and the Sofcom Group could increase to 39.73% if only CXL and the Sofcom Group took up their rights (**Rights**) under the Rights Issue;
- F. there is no immediate or compelling need for the Rights Issue, nor any pressing need for it to occur before two proposed shareholder meetings which may remove the uncertainty as to the status of the incumbent board of RFS and the contest for control of RFS;
- G. the Rights Issue is not in pursuance of a course which had been approved by shareholders, notwithstanding that it is likely that shareholder approval will be required for a proposed spin off of RFS' Avcol business;
- H. there is inadequate disclosure in the Rights Issue prospectus of the potential impact of the Rights Issue on the control of RFS;
- I. the Rights Issue was announced on 24 December 2004 and conducted over the Christmas-January period in accordance with the minimum timetable permitted under the Australian Stock Exchange Listing Rules, and there had been no earlier indication to the market of the intention to make the Rights Issue;
- J. the pricing of the Rights Issue is such that the discount is at the lower end of discounts that would have encouraged take-up of Rights or significant trading in Rights; and

- K. the structure of the Underwriting and the process leading to its implementation were likely to increase rather than minimise the shortfall taken up by CXL under the Rights Issue and were such that the sub-underwriter would not be receiving any benefit which could reasonably be seen as offsetting the risk of having to take up the shortfall other than increased control over RFS.

Under section 657A of the Corporations Act, the Takeovers Panel declares that the combination of the circumstances set out in recitals A to K constitute unacceptable circumstances in relation to the affairs of RFS.

**Simon McKeon**

**President of the Sitting Panel**

Dated 18 January 2005

## **Annexure B**

### **Undertakings by Rivkin Financial Services Limited**

Rivkin Financial Services Limited (**RFS**) undertakes, pursuant to section 201A of the ASIC Act 2001, that

- (i) RFS will not proceed with the 1 for 3 pro rata renounceable rights issue (the **Rights Issue**) proposed to be conducted by it pursuant to a prospectus dated 24 December 2004 unless each acquisition of a relevant interest in shares in RFS by a Nominated Person pursuant to the underwriting and sub-underwriting arrangements associated with the Rights Issue is approved at least 7 days before the commencement of trading in the rights on Australian Stock Exchange Limited (**ASX**) under item 7 of section 611 of the Act and on the basis that each Nominated Person is regarded as an associate of each other Nominated Person; and
- (ii) until 3 months after the date of these orders, RFS will not make any rights offer which might result in any Nominated Person acquiring a relevant interest in shares in RFS pursuant to an underwriting or sub-underwriting arrangement which results in an increase in the collective voting power of all Nominated Persons to or further above 20%, unless the acquisition of the relevant interest by the Nominated Person is approved at least 7 business days before the commencement of trading in the rights on ASX under item 7 of section 611 of the Act and on the basis that each Nominated Person is regarded as an associate of each other Nominated Person.

For the purposes of these orders, each of the following is a Nominated Person:

- (A) Altera Capital Limited;
- (B) Central Exchange Limited;
- (C) Fast Scout Limited;
- (D) Queste Communications Limited;
- (E) Sofcom Limited;
- (F) Westchester Financial Services Pty Limited;
- (G) each officer, associate and related party (within the meaning of section 228 of the Act) of any of the companies identified in paragraphs (A) to (F) as at the date of this undertaking and from time to time while this undertaking remains in force; and
- (H) each entity of or with whom any of the persons identified in paragraph (G) is an officer, associate or related party (within the meaning of section 228 of the Act) as at the date of this undertaking and from time to time while this undertaking remains in force.

**Farooq Khan**

**Chairman**

**Rivkin Financial Services Limited**

**Dated 18 January 2005**