



**Australian Government**

**Takeovers Panel**

**Reasons for Decision  
Virgin Australia Holdings Limited  
[2013] ATP 15**

**Catchwords:**

*Decline to make a declaration – derivatives – dispersion strategy – effect on control – equal opportunity – rights issue – shortfall shares – standing – underwriting*

*Corporations Act 2001 (Cth), sections 602(a), 602(c), 606, items 9 and 10A of section 611*

*Guidance Note 17 Rights Issues, Guidance Note 20 Equity Derivatives*

*Leighton Holdings Limited 02R [2010] ATP 14, Bisalloy Steel Group Limited [2008] ATP 29, Midwest Corporation Limited 02 [2008] ATP 15, Dromana Estate Limited 01R [2006] ATP 8, Rivkin Financial Services Limited 02 [2005] ATP 1, Austar United Communications Limited [2003] ATP 16*

Interim order	IO undertaking	Conduct	Declaration	Final order	Undertaking
No	No	Yes	No	No	No

**INTRODUCTION**

1. The Panel, James Dickson, Hamish Douglass (sitting President) and Paula Dwyer, declined to make a declaration of unacceptable circumstances in relation to a 5 for 14 entitlement offer announced by Virgin Australia on 14 November 2013. The Panel considered that neither the cap on applications by shareholders for additional shares nor the use of cash settled derivatives as synthetic sub-underwriting arrangements had a material control effect.
2. In these reasons, the following definitions apply.

<b>Air NZ</b>	Air New Zealand Associated Companies Ltd
<b>Etihad</b>	Etihad Airways PJSC
<b>FIRB</b>	Foreign Investment Review Board
<b>Goldman Sachs</b>	Goldman Sachs Australia Pty Ltd
<b>Singapore Airlines</b>	Singapore Airlines Ltd
<b>UBS</b>	UBS AG, Australia branch
<b>Virgin Australia</b>	Virgin Australia Holdings Limited

**FACTS**

3. Virgin Australia is an ASX listed company (ASX code: VAH).
4. On 14 November 2013, Virgin Australia announced a fully underwritten 5 for 14 pro rata accelerated non-renounceable entitlement offer to raise approximately \$350 million.

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5. The entitlement offer price was \$0.38 per share, a 6.2% discount to the Virgin Australia share price prior to announcement of the entitlement offer (\$0.405) and a 4.6% discount to the theoretical ex-rights price of \$0.40.
6. In addition to their entitlements, both institutional and retail shareholders were entitled to apply for shortfall shares up to a maximum of 40% of their entitlements. Applications for additional shares by institutional shareholders could be satisfied from any entitlements not taken up by institutional shareholders. Similarly, applications for additional shares by retail shareholders could be satisfied from any entitlements not taken up by retail shareholders.
7. The entitlement offer was underwritten by UBS and Goldman Sachs.
8. The institutional component of the entitlement offer was completed on 15 November 2013, raising \$281.4 million (98.4% participation). The retail component opened on 25 November 2013 and closed on 9 December 2013.
9. Prior to the entitlement offer, Virgin Australia's three largest shareholders were Air NZ (22.9%), Etihad (19.9%) and Singapore Airlines (19.8%). In conjunction with the announcement of the entitlement offer, Virgin Australia announced it intended to work with these shareholders regarding future board representation with "appropriate protocols".
10. Air New Zealand, Etihad and Singapore Airlines each committed to take up their entitlements. Air New Zealand sub-underwrote the offer in relation to approximately 92.5 million shares (\$35.2 million). Etihad and Singapore Airlines committed to enter into cash settled derivatives as synthetic sub-underwriting arrangements that may have resulted in them increasing their economic exposure by a further \$30.5 million and \$30.4 million respectively. None of the three applied for shortfall shares.
11. Virgin Group (Virgin Australia's fourth largest shareholder with a 10% interest) took up its entitlements and was offered the opportunity to sub-underwrite but did not do so.
12. Following the institutional entitlement offer, if there was no take-up under the retail entitlement offer the following changes would occur:
  - (a) Air New Zealand's relevant interest would increase from 23.0% to 25.0%
  - (b) Etihad's aggregate exposure would increase from 20.0% to 21.7% and
  - (c) Singapore Airline's aggregate exposure would increase from 19.8% to 21.6%.<sup>1</sup>
13. Virgin Australia's announcement of the entitlement offer stated that Etihad and Singapore Airlines were seeking regulatory approvals to increase their shareholdings in the company.
14. Each of Air New Zealand, Etihad and Singapore Airlines were paid a fee of 0.75% of their sub-underwriting or cash settled derivative commitments.

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<sup>1</sup> These figures are lower than the maximum figures of 25.5%, 22.2% and 22.1% respectively contained in Virgin Australia's announcement of the entitlement offer because of completion of the institutional component of the entitlement offer

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15. The free float of Virgin Australia could reduce from 27.4% to 21.8%<sup>2</sup> following the entitlement offer.
16. The booklet for the retail entitlement offer stated:
  - (a) *the cap of 40% is broadly consistent with the maximum additional participation that the Major Shareholders can achieve beyond their Entitlements through either the sub-underwriting or economic hedge arrangements and*
  - (b) *New Shares...will:*
    - *first be used to satisfy valid Applications for Additional New Shares under the Retail Oversubscription Facility; and*
    - *if not taken up under the Retail Oversubscription Facility, be placed to the Underwriters and, by extension, to Air New Zealand as sub-underwriter or an exposure provided to Etihad Airways and Singapore Airlines through the cash settled derivatives.*

## APPLICATION

17. By application dated 22 November 2013, Mr Stephen Mayne sought a declaration of unacceptable circumstances. Mr Mayne submitted that:
  - (a) the entitlement offer was structured to concentrate the control of Air New Zealand, Etihad and Singapore Airlines at the expense of other shareholders. In particular, he submitted that there should not have been a cap on shareholders' applications for additional shares
  - (b) Etihad may acquire a relevant interest in Virgin Australia in excess of 20% otherwise than as permitted by Chapter 6<sup>3</sup> and
  - (c) the terms of the underwriting, sub-underwriting and cash settled derivative arrangements and any steps by Virgin Australia to find other sub-underwriters (including through derivative arrangements) had not been fully disclosed.
18. Mr Mayne submitted that the concentration of control was taking place otherwise than in an efficient, competitive and informed market and that shareholders had been denied a reasonable and equal opportunity to participate in the benefits of the entitlement offer.

## Final orders sought

19. Mr Mayne sought final orders to the effect that:
  - (a) retail shareholders be allowed to apply for additional shares without limit and be guaranteed a minimum allocation of 37,500 shares (\$15,000), if they apply for at least that amount

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<sup>2</sup>Higher than the announcement figure of 20.2% after completion of the institutional component of the entitlement offer. This figure is based on the aggregate exposure of Air NZ, Etihad, Singapore Airlines and Virgin Group

<sup>3</sup>References are to the *Corporations Act 2001 (Cth)* unless otherwise stated

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- (b) any shares issued to underwriters or sub-underwriters are issued only after all shortfall applications are satisfied to the maximum extent possible and
- (c) Etihad be prevented from obtaining an economic or relevant interest in Virgin Australia shares exceeding 20%.

## DISCUSSION

### Standing

20. Mr Mayne owns 29 Virgin Australia shares (value approximately \$11). He has held them since at least 2008. Virgin Australia submitted that there was a “*serious question whether this insignificant interest gives him standing.*” We consider Mr Mayne has standing.<sup>4</sup>

### Control effect

21. Guidance Note 17 *Rights Issues* states that the Panel will consider “*whether the control effect exceeds what is reasonably necessary for the fundraising purpose.*”<sup>5</sup>
22. Mr Mayne submitted that the entitlement offer would entrench the pre-offer shareholding structure “*held by the ‘big 4’ from around 73% to around 79%. This is almost guaranteed by the structure of the Rights Issue, including the pricing, the non-renounceability, the 40% cap on shortfall participation and the sub-underwriting of the entire shortfall by the three major airline shareholders.*”
23. Etihad and Singapore Airlines would not increase their voting interests via the cash settled derivatives. However, their commitments through the cash settled derivatives created synthetic sub-underwriting arrangements so that, in substance, the potential outcome from the entitlement offer was as described by Mr Mayne.
24. Mr Mayne further submitted that “[*t*he resulting reduction in the free float of VAH shares from around 27% to around 21% is substantial, and is likely to significantly reduce the opportunity for any other investor to acquire a position of influence as a substantial shareholder.”
25. Virgin Australia submitted that the entitlement offer “*does not entrench any party’s shareholding in Virgin Australia in the sense that their holdings remain virtually unchanged...mere maintenance, or a small increase, of the pre-offer shareholding structure through the Entitlement Offer offends neither the letter nor the policy of Chapter 6.*”
26. In *Bisalloy Steel Group Limited*<sup>6</sup> the Panel said that reasonable steps to minimise the potential control impact of a rights issue may include appointing a number of underwriters.<sup>7</sup> Here, effectively three sub-underwriters have been appointed.
27. The sub-underwriting and synthetic sub-underwriting arrangements have the effect that any shortfall will be dispersed between the three largest shareholders in

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<sup>4</sup> *Austar United Communications Limited* [2003] ATP 16 at [56], *Leighton Holdings Limited* 02R [2010] ATP 14 at [15]

<sup>5</sup> At [5]

<sup>6</sup> [2008] ATP 29 at [23]

<sup>7</sup> At [23]

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proportion to their pre-offer interests. This will maintain their relative positions on the Virgin Australia register.

28. The maximum<sup>8</sup> potential increase in any of the interests of the three largest shareholders was 2.1% (Air NZ). The maximum potential increase that the three sub-underwriters could achieve in total was 5.6%. The free float will decrease to the extent that retail shareholders do not take up their entitlements. The shortfall will be dispersed between the three largest shareholders. In this case, overall we do not consider this will have any material effect on the control of Virgin Australia and we do not consider this is beyond what is reasonably necessary, given Virgin Australia's register composition and the commercial rationale for the fundraising.
29. Mr Mayne submitted that, as in *Midwest Corporation Limited 02*,<sup>9</sup> a relatively small percentage of shares can be significant in terms of its potential effect on control, depending on the context.
30. Virgin Australia submitted:

*The applicant draws an analogy between the Entitlement Offer and the events considered in Midwest Corporation Ltd 02, where the acquisition of a 4% parcel was found to have such an effect on a bid that it led to unacceptable circumstances. However, that purchase materially affected a takeover bid, by supporting the market in Midwest shares at a critical juncture during that bid and because the purchaser was likely to be able to block compulsory acquisition. The circumstances of the Virgin Australia Entitlement Offer are entirely different to those of Midwest Corporation Ltd.*
31. Although a relatively small percentage of shares can be significant in terms of its potential effect on control, the circumstances here are different to those in *Midwest 02*. That matter concerned an acquisition of shares that should not have occurred in the context of competing proposals. The question for us in this case is whether the potential acquisition of shares by the three largest shareholders as part of an entitlement offer may have a control effect. We think not, for the reasons given above.
32. A transaction that increases or maintains the relative positions of large shareholders and reduces the free float materially could have an unacceptable control effect. In this case, had the shortfall been dispersed less widely or had there been a potentially greater effect on the interest of any of the largest shareholders, our conclusion in respect of the control effect may have been different.

#### Cap on applications

33. At the time the entitlement offer was announced each of Air NZ, Etihad and Singapore Airlines could have acquired up to 43.7%<sup>10</sup> of its entitlements through the sub-underwriting/synthetic sub-underwriting arrangements. Following completion of the institutional offer this figure reduced to 33.9%.

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<sup>8</sup> Maximum potential difference between the pre and post entitlement offer holdings given completion of the institutional component of the entitlement offer had already occurred

<sup>9</sup> [2008] ATP 15

<sup>10</sup> If there was no take-up under the entitlement offer other than Air NZ, Etihad, Singapore Airlines and Virgin Group

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34. Virgin Australia submitted that it wanted to “ensure that all shareholders were provided with the same opportunity to apply for additional shares beyond their entitlements” and that “following the strong take up in the institutional component of the Entitlement Offer, a retail shareholder is able to increase its percentage holding in Virgin Australia by participating in the shortfall facility by materially more than the Airlines through their support arrangement.” It further submitted that if retail shareholders were provided with the opportunity to participate on an uncapped basis they would “be inequitably advantaged in comparison to the Airlines.”
35. In *Rivkin Financial Services Limited 02* the Panel said that “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. Alternatively, it could obtain shareholder approval for the underwriting arrangements. To do otherwise is inconsistent with the equal opportunity principle in section 602(c).”<sup>11</sup>
36. In *Dromana Estate Limited 01R* the Panel found a cap on applications for additional shares to be unacceptable and stated that “as a general rule any shareholder should be able to participate fully in the shortfall subject only to:
- (a) the limits under the Corporations Act that might apply to that shareholder; and
  - (b) the number of shares available given the applications.”<sup>12</sup>
37. The outcome of the entitlement offer (given the take-up of the institutional component) is that individual retail shareholders have an opportunity to apply for shares proportionally slightly higher than the maximum that Air NZ, Etihad and Singapore Airlines may acquire (directly or synthetically).
38. ASIC submitted that “the shortfall facility and underwriting arrangements will generally serve distinctly different purposes...[i]t follows that disproportionate or unequal treatment between participants in a shortfall facility and underwriters will often be appropriate and necessary in order for a shortfall facility to fulfil its role in mitigating the potential control effect.” We agree with ASIC.
39. Each of Etihad and Singapore Airlines was limited in its capacity to apply for additional shares under the shortfall facility:
- (a) Etihad had neither ‘creep’ capacity<sup>13</sup> nor FIRB approval to increase its interest and
  - (b) Singapore Airlines had ‘creep’ capacity<sup>14</sup> but not FIRB approval to increase its interest.
40. Air NZ had FIRB approval to increase its interest and could acquire shares under ‘creep’ capacity from 5 December 2013.

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<sup>11</sup> [2005] ATP 1 at [67]

<sup>12</sup> [2006] ATP 8 at [45]

<sup>13</sup> Etihad held its 19.9% pre-offer interest from 8 October 2013

<sup>14</sup> Singapore Airlines held its 19.8% pre-offer interest from 23 April 2013

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41. We consider that the imposition of the retail cap and sub-underwriting arrangements would maintain the relative positions of each of the three largest shareholders and would not disadvantage retail shareholders on a proportionate basis.
42. While there may have been other structures that may have been more advantageous to retail shareholders, it is not the Panel's role to determine whether an alternative transaction structure would have been preferable. It is the Panel's role to determine whether the actual transaction structure is unacceptable. In all the circumstances we do not consider the cap unacceptable.

#### Cash settled derivatives

43. Neither Etihad nor Singapore Airlines could enter traditional sub-underwriting arrangements with Virgin Australia because they did not have FIRB approval to increase their holdings. However, their cash settled derivatives arrangements with UBS allowed them to substantively sub-underwrite the entitlement offer. Had Etihad or Singapore Airlines acted as sub-underwriters they could have relied on item 10A<sup>15</sup> of s611.
44. Mr Mayne submitted that *“both Etihad and Singapore Airlines have, through their contrived cash equity swap arrangements, a relevant interest in the VAH shares that will be delivered to them...promptly after they obtain the envisaged regulatory approvals.”*
45. Etihad submitted that under the terms of the cash settled derivative it would *“not acquire any voting or disposal right in Virgin Australia shares...there are no grounds to conclude that Etihad's execution of the cash settled equity derivative...contravenes section 606.”*
46. Regardless of whether the cash settled derivatives confer a relevant interest, which may have resulted in a breach of s606, the commercial reality of a derivative of this type is that it is highly likely to be hedged by the writer (the underwriter in this case, which would be allocated shares to the extent of any shortfall) and that, when it is unwound, it is highly likely that the taker will acquire the underlying shares, even though it has no obligation to do so. It is for this reason primarily that Guidance Note 20 *Equity Derivatives* states that non-disclosure of long positions may give rise to unacceptable circumstances.<sup>16</sup>
47. It could give rise to unacceptable circumstances for a party to 'put its foot' on shares through the use of derivatives. That may be particularly so if the derivative gives the party what the law would not allow (e.g. banking 'creep'). However, the circumstances would likely only be unacceptable if that had a material control effect on a company or could result in the acquisition of a substantial interest. That is not the case here. Further, the effect of the cash settled derivatives has been disclosed.

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<sup>15</sup> ASIC Class Order 09/459 *Takeovers relief for accelerated rights issues*

<sup>16</sup> At [9]

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### **DECISION**

48. For the reasons above, we declined to make a declaration of unacceptable circumstances. We consider that it is not against the public interest to decline to make a declaration and we had regard to the matters in s657A(3).

### **Orders**

49. Given that we made no declaration of unacceptable circumstances, we make no final orders, including as to costs.

**Hamish Douglass**

**President of the sitting Panel**

**Decision dated 2 December 2013**

**Reasons published 12 December 2013**



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### Advisers

Party	Advisers
Etihad	DLA Piper
Mr Stephen Mayne	Landerer & Company
Virgin Australia	Herbert Smith Freehills