Yesterday Ocado announced that it had carried out a £36 placing, allowing it to refinance a £100 debt facility used to fund a new distribution facility in Warwickshire.

As a result, Ocado's banks agreed to extend the facility by 18 months to July 2015. (The extension to its facility was dependent on raising fresh cash.) According to Tim Steiner, Ocado Chief Executive, raising funds through a pre-emptive rights issue would have been "messy". The company was concerned that short sellers who had amassed more than a quarter of the company's shares in betting that the company's shares would fall, due to increased concerns it would breach its banking covenants, could have tried to block its plans. By structuring the capital raising as a "cashbox placing", existing shareholders pre-emption rights were bypassed. Those shareholders not invited to participate in the placing, find themselves having been diluted without having having had a say in the matter.

Whilst the cashbox structure has been used relatively sparingly in recent years the cashbox placing is not a new concept. Between mid December 2008 and the end of January 2009 more than £30 billion was raised by UK companies using the cashbox structure, including the state backed share issues of Royal Bank of Scotland, Lloyds and HBOS. (In the case of the banks it was dependent on raising fresh cash). According to Tim Steiner, Ocado Chief Executive, Ocado was concerned that short sellers who had amassed more than a quarter of the company's shares in betting that the company's shares would fall, due to increased concerns it would breach its banking covenants, could have tried to block its plans. By structuring the capital raising as a "cashbox placing", existing shareholders pre-emption rights were bypassed. Those shareholders not invited to participate in the placing, find themselves having been diluted without having having had a say in the matter.

For some time the use of the cash box structure has led to concern among some shareholders who regard it as an abuse of their pre-emption rights. Back in early February 2009, Peter Montagnon, director of investment affairs at the Association of British Insurers (ABI), a leading shareholder protection organisation, wrote expressing concern to the London Investment Banking Association and calling on the Pre-Emption Group\(^1\) Statement of Principles (Principles), which are discussed below, to be observed. If there is a renaissance in the use of cashbox placings early positive engagement with shareholders is a must and, if justified, we may see their use increase. This briefing explains shareholders pre-emption rights, how they are avoided by and the principal steps involved in a cashbox structure.

\(^1\)Pre-emption rights and principles

Except with and to the extent of existing shareholder approval, a UK company carrying out a cash fundraising is legally obliged to offer new shares first to their existing shareholders (pre-emption rights). Pre-emption rights are designed to prevent dilution of existing shareholders' investment.

Listed companies routinely disapply pre-emption rights up to 5% of ordinary share capital on an annual basis with a cumulative limit of 7.5% in any three year rolling period with a maximum discount of no more than 5% to the mid market price. Routine disapplication is normally sought at companies' annual general meetings. Additional disapplication is sought at a general meeting of shareholders.

The Principles expressly permit companies to use a "cash box structure" to issue up to 10% of their share capital on a non pre-empive basis in order to fund an acquisition. In cases where the new equity has represented more than 10% of the issued share capital, market practice has been to give existing shareholders the right to "claw back" the new shares.

Avoiding pre-emption rights

Pre-emption rights do not apply to the cashbox structure because the company, instead of receiving cash in consideration of the issue of the new shares, will receive the entire issued share capital of a cash box company, a company whose only assets are cash reserves (i.e. the issue is structured as a non-cash issue).

The use of the "cash box" structure has never seemingly been the subject of a legal challenge on the basis that it is a device to avoid pre-emption rights. Some lawyers have speculated on the basis of a legal challenge and the likelihood of it succeeding. Would the courts be willing to "pierce the corporate veil" and regard the company as receiving cash as consideration
for the new shares and therefore the issue should be made on a pre-emptive basis? Historically, the courts have generally been resistant to piercing the corporate veil unless dishonesty has been present. Would the courts determine that the structure was a “sham” (i.e. where there is an intention to create a “false appearance of legal rights and obligations”)? The cash box structure is unlikely to be a sham as the intention is to create legally enforceable relations and there is an absence of dishonesty. Could a shareholder claim that he had been “unfairly prejudiced” by reason of the structure avoiding his pre-emption rights? As the cash box structure is regarded as a non cash issue and pre-emption rights only apply to cash issues, it would be difficult to show “prejudice”. It is worth mentioning that non cash issues normally require an independent valuation. However, there is a specific exemption where the consideration is provided by a transfer to the listed company of the entire issued share capital of another company.

The cash box structure - the principal steps

Step 1
The company incorporates a new company which to avoid UK stamp duty and for other benefits is likely to be a Jersey company (Jerseyco). Jerseyco’s share capital will comprise two classes of shares, ordinary shares and redeemable preference shares, both with zero nominal (par) value. (Jersey company law allows Jersey incorporated companies to issue shares of zero nominal value).

Step 2
The company’s investment bank or broker will subscribe for some of Jerseyco’s ordinary shares (usually in excess of 10%) and the company will hold the balance of Jerseyco’s ordinary shares (usually representing less than 90% of such ordinary shares).

Step 3
The bank or broker will subscribe for Jerseyco redeemable preference shares and will undertake to pay Jerseyco the subscription price for those shares, conditional upon the admission of the new shares to be issued by the listed company to the relevant market. (The subscription price for the preference shares will be equal to the proceeds of the new share issue less commissions and other expenses).

Step 4
The company will allot new ordinary shares to placees procured by the bank or broker. The bank or broker receives and uses the net proceeds to discharge its payment undertaking to Jerseyco in respect of its preference shares subscription.

Step 5
The preference shares and the ordinary shares in Jerseyco issued to the bank (or broker) are transferred to the company in consideration of the issue of the new shares to the placees. Jerseyco is then a wholly owned subsidiary of the company.
Structuring cash issues using the cashbox structure – playing fair with shareholders’ pre-emption rights?

Step 6

The redeemable preference shares are redeemed and the cash returned to the listed company. The amount of distributable reserves created in the listed company will be an amount of the redemption proceeds less the nominal value of the placing shares. Typically Jerseyco is then liquidated by the directors. (Jersey law provides that a liquidator is not needed to be appointed).

Conclusion

Companies considering structuring a cash issue as a cashbox structure should be mindful of the views of their shareholder base and the perception of the wider investor community. Under the Principles, companies have a responsibility to signal an intention to seek a non pre-emptive issue at the earliest opportunity. Using the cashbox structure to raise capital opportunistically without proper dialogue with investors, as a few companies have been alleged to have done, is best avoided.

¹The Pre-Emption Group was set up in 2005 to produce a Statement of Principles to be taken into account when considering the case for disapplying pre-emption rights. Its members represent listed companies, investors and intermediaries