AN ANALYSIS OF RIGHTS OFFERS: THEIR ADVANTAGES AND DRAWBACKS

Maleka Femida Cassim
MBBCh (cum laude) LLB (cum laude) LLM (cum laude) PhD
Attorney and Notary Public of the High Court of South Africa
Professor of Law, Mercantile Law Department, University of South Africa

SUMMARY

A rights offer is a useful mechanism for raising fresh corporate finance, particularly for a listed company with a wide shareholder base. The regulation of rights offers in South African law is critically analysed in this article. This is followed by a comparative analysis of rights issues in the United Kingdom and in Australian law. The advantages and drawbacks of rights issues in practice are also discussed, with reference to recent rights offers launched by prominent JSE-listed companies.

1 INTRODUCTION

A rights issue refers to the opportunity offered by a company to its existing shareholders – and to its existing shareholders only – to acquire additional shares in the company at a discounted price. The existing shareholders are given the right, though not the obligation, to acquire the new shares directly from the company on the primary market, without having to access the secondary market to buy the shares. It is up to the shareholder to decide whether to accept or decline these rights, or in certain cases to transfer these rights to a third party. The shareholders who take up the rights acquire the new shares at a price lower than the market price, and gain increased exposure to the company's shares. These are valuable benefits to the shareholder if the company is exhibiting growth.[1]

A company typically makes a rights offer in order to raise new capital. The fresh capital in some instances may be required to clear the company's debt obligations when it is faced with a shortage of cash. In other instances, it may be used to acquire new assets or technology, or to facilitate the growth and expansion of the company without it having to obtain a loan from a bank

[1] MF Cassim and FHI Cassim *Law of Corporate Finance* (2021) 428–429.

or other financial institution. The advantage for the company is that it may tap its existing shareholder base for finance by inviting its shareholders to subscribe for more shares, so that the company does not need to approach a financial institution to raise funds, especially where the company is already in debt. For listed companies with a wide shareholder base, a rights offer is an expedient and useful method of raising finance. A chief drawback, however, is that a rights issue is by its nature dilutive, since it results in a dilution of the value of the existing shares in the company.

Heading 2 of this article critically analyses the regulation of rights offerings in South African law. This is followed by a brief comparative analysis of rights issues in the United Kingdom and in Australian law under Heading 3. Heading 4 discusses the benefits and drawbacks of rights offerings in practice, using as illustrative cases three rights offers that were recently launched by prominent South African companies listed on the Johannesburg Stock Exchange – namely, Nampak Ltd, EOH Holdings Limited and Tongaat Hulett Limited.

2 RIGHTS OFFERS AND THE COMPANIES ACT 71 OF 2008

2 1 The concept of a rights offer

Rights offers as a mechanism for raising fresh corporate finance are commonly made by listed companies with a broad shareholder base, and which have already previously made an initial public offering (IPO) of their shares. A rights offer must be distinguished from an IPO, in which the company's shares are issued to the general public for the first time,[2] accompanied by a lengthy and detailed registered prospectus.[3] As for a rights offering, the Companies Act 71 of 2008 (the Act) defines a rights offer as an offer, with or without a right to renounce in favour of other persons, made to any holders of a company's securities for subscription of any securities of that company, or any company within the same group of companies.[4] According to this definition, a rights offer need not necessarily be in respect of listed shares; it may be an offer of unlisted shares. It, moreover, need not necessarily be renounceable but could be non-renounceable. A narrower definition of a rights offer pertained under the previous company-law regime, under which the concept of a rights offer by definition related only to offers that were renounceable, and only to offers of listed shares.[5]

It appears from the definition in section 95(1)(*l*) of the Act that a rights offer does not necessarily have to be made to the company's shareholders pro rata or in proportion to their existing shareholdings in the company. Thus, the shareholders do not necessarily have the benefit of pre-emptive

---

2 As defined in s 95(1)(*e*) of the Companies Act 71 of 2008 (the Act).

3 As required by s 99(2) of the Act.

4 S 95(1)(*l*) of the Act.

5 In terms of s 142(1) of the Companies Act 61 of 1973 (1973 Act).

rights.[6] In the case of listed companies, however, the JSE Listings Requirements typically require a company's Memorandum of Incorporation to contain a provision requiring all issues of shares ordinarily to be on a pro-rata pre-emptive basis, except in certain limited circumstances or unless otherwise approved by the shareholders. In this respect, the JSE Listings Requirements are aligned with the traditional definition of a rights issue in Australian law.[7] One of the main definitional elements of a rights issue in the Australian statute is that the offer must be pro rata. Likewise in the United Kingdom (UK), a standard rights issue in accordance with the Listings Rules is necessarily a pro rata offer.[8]

As for unlisted public companies in South Africa, the default position under the Act is that shareholders in a public company do not have pre-emptive rights in respect of the issue of new shares by the board of directors, unless the Memorandum of Incorporation of the public company specifically so provides.[9] There is, however, a safeguard for shareholders in these cases, in that the approval of the shareholders by special resolution is required for an issue of shares (such as in a rights offer) if the voting power of the class of shares issued or to be issued pursuant to the transaction will be equal to or will exceed 30 per cent of the voting power of all the shares of that class held by shareholders immediately before the transaction.[10]

2 2 The disclosure regime for rights offers

When a rights offer is meticulously structured so as to qualify for one of the exemptions or safe harbours contained in section 96(1)(*c*) or (*d*) of the Act, the issuer company will conveniently be exempted from having to draw up and issue a prospectus. This is an important advantage.

The preparation of a prospectus is an expensive and arduous task. Its underpinning objective is investor protection. The cardinal purpose of a prospectus (as expressed in leading US case *SEC v Ralston Purina Co* and Australian cases *Cadence Asset Management Pty Ltd v Concept Sports Ltd* and *Hurst v Vestcorp*)[11] is to provide information to investors and offerees who are unable to fend for themselves, and thus need the protection of a prospectus. The rules and requirements of a registered prospectus are

[6] A right of pre-emption, in broad terms, is a right conferred on the shareholders of the company to subscribe for a pro rata portion of any new shares to be issued by the company, in proportion to their existing holdings, so that shareholders may preserve their existing stakes in the company, particularly their control rights (MF Cassim and FHI Cassim *Law of Corporate Finance* 154–155).

[7] See s 9A of the Australian Corporations Act 2001.

[8] According to the UK Listings Rules, a rights offer is an offer to existing shareholders in proportion to existing holders made by way of a renounceable letter of allotment, with compensation for shareholders that do not take up their rights or sell them, and with special arrangements for overseas shareholders, treasury shares and fractions.

[9] S 39(1)(*a*) of the Act.

[10] S 41(3) of the Act.

[11] See *SEC v Ralston Purina Co* (1953) 346 US 119; *Cadence Asset Management Pty Ltd v Concept Sports Ltd* (2005) 55 ACSR 145; *Hurst v Vestcorp Ltd* (1987) 13 ACLR 17 CA (NSW).

aimed at ensuring that mandatory disclosure is made to the investing public of all the relevant information on the company's performance, its prospects and its shares that they need in order make a fully informed decision whether to invest in the shares or securities of the company.[12] All the information contained in the prospectus must be carefully verified for accuracy and completeness in a due diligence process, so as to curtail the risk of litigation being launched by aggrieved investors who acquired shares in the company on the faith of its prospectus. To deter companies and their directors from any temptation to embellish the information presented in the prospectus, the Act has adopted an array of robust legal remedies for investors who acquired shares that were offered to the public pursuant to a false or misleading prospectus.[13] While aggrieved investors may also resort to the common-law remedies, which are preserved by the Act,[14] the statutory remedies adopted by the Act are substantially more daunting and more severe for the company, its directors and its expert advisers.[15]

Much of this may be conveniently avoided by a company making a rights offer if its particular rights offering is shielded by one of the exemptions contained in section 96 of the Act. The list of seven safe harbours set out in section 96(1) is designed largely to cover situations where prospective investors are able to fend for themselves so that they do not require protection by means of a full prospectus, or where the offerees will receive the relevant information through some other mechanism – as in the case of rights offers of listed shares. Where an exemption applies, not only is the issuer company relieved of the expense and administrative burden of having to publish a registered prospectus that complies with the Act, but it is also (seemingly) relieved of the potent liability regime for false and misleading prospectuses under the Act.

As a starting point, an offer of securities by a company to its own shareholders is, in principle, an offer to a section of the public. It is notable in this regard that the definition of an "offer to the public" specifically includes an offer of securities to be issued by a company to its own securities holders.[16] Where a rights offer is made, it may be excluded from the ambit of the definition of an "offer to the public" or the definition of "primary offering"[17] if it qualifies for one of the two safe harbours that the Act provides for rights offers. These are section 96(1)(*d*), which exempts a rights offer in respect of listed securities, and section 96(1)(*c*), which creates an exclusion for non-renounceable rights offers. If, however, the rights offer in question qualifies for neither of the two safe harbours – for example, if it is a renounceable rights offer of unlisted securities, then the particular rights offering could

[12] MF Cassim and FHI Cassim *Law of Corporate Finance* 389–393.
[13] See ss 104–106 and s 214 of the Act.
[14] In terms of s 95(6) of the Act.
[15] See further MF Cassim and FHI Cassim *Law of Corporate Finance* ch 14.
[16] See s 95(1)(*h*)(i)(*aa*) of the Act.
[17] In terms of s 95(1)(*i*) of the Act.

amount to an offer to the public that would have to be accompanied by a registered prospectus.

The two exemptions for rights offerings are discussed below in turn.

2 3 The section 96(1)(*d*) safe harbour

An offer is deemed not to be an offer to the public (and as such is exempt from the requirement of a prospectus in terms of section 96(1)(*d*)) if it is a rights offer[18] that satisfies the prescribed requirements, and (i) an exchange has granted or has agreed to grant a listing for the securities that are the subject of the offer, and (ii) the rights offer complies with any relevant requirements of that exchange at the time the offer is made. The reason that rights offers of listed securities are exempted by section 96(1)(*d*) from the public-offer prospectus rules is that the disclosure of necessary information concerning the offer will be caught by the disclosure rules and the requirements of the relevant exchange. Since the offerees will receive the information through another mechanism, there is no need for the publication of a full prospectus. Moreover, much information on listed companies is already available in the public domain. Listed companies are subject to disclosure obligations and are under the constant scrutiny of the investing public, financial analysts and the media.[19] The section 96(1)(*d*) safe harbour is aimed at making capital-raising more flexible. This serves to balance the protection of the public with the needs of a company. By the avoidance of duplication, the cost burden and the administrative burden on the issuer company are reduced.

Although a section 96(1)(*d*) rights offer need not be accompanied by a registered prospectus under the Act, a rights-offer circular must usually be distributed to the shareholders under the JSE Listings Requirements. The rights-offer circular discloses to the shareholders essential information such as the rationale for the rights offer, details of the rights offer, the use of the proceeds and the state of the company's affairs. The Companies Regulations[20] provide that a rights offer in respect of listed securities, and all documents issued in connection with it, must satisfy the requirements that would apply to a prospectus in terms of the Act[21] and regulation 51 on the general requirements for a prospectus.[22] In addition, there is a statutory prohibition on the issue, distribution or delivery of letters of allocation of listed securities, by means of which rights offers are made to shareholders, unless they are accompanied by all the required documents and are approved by the relevant exchange.[23] The letter of allocation, the accompanying documents and the other requirements of the exchange fulfil the disclosure needs of investors and the objective of investor protection.

---

18 As defined in s 95(1)(*l*), discussed above.
19 See further MF Cassim and FHI Cassim *Law of Corporate Finance* 429.
20 GNR 351 in *GG* 34239 of 2011-04-26.
21 In terms of ss 101 and 102 of the Act.
22 Reg 50 of the Companies Regulations.
23 S 99(4) of the Act.

Disclosure alone is, however, not a sufficient safeguard to protect investors. A parallel safeguard is needed: a strong liability regime for false or misleading disclosure documents. The approach of regulation by mandatory disclosure, as adopted in Chapter 4 of the Act, puts the burden on the company to disclose the whole truth in its prospectus or other disclosure document. A regulatory system that is centred on investor protection through mandatory disclosure of information is effective only if it is given teeth by means of severe sanctions for non-disclosure. Potent liability must be imposed on the company and those who are responsible for disclosing the information in order to ensure that full and accurate information is disclosed, and to deter them from any temptation to embellish, or to provide false information or half-truths, or to make misleading omissions in the prospectus or other disclosure documents.

Although Chapter 4 of the Act has adopted a laudably severe liability scheme for false and misleading prospectuses, it is plagued by a gaping lacuna: the liability provisions of Chapter 4 seemingly apply only to a “prospectus”, but do not extend to rights-offer documents that contain false or untrue statements. Chapter 4 is silent on whether prospectus-type liability extends to documents issued in connection with a rights offer. Based on the literal interpretation of section 104 of the Act, the statutory claim for compensation for false or untrue statements applies only where those untrue statements are contained in a “prospectus”. The difficulty is compounded by the lack of a definition of a “prospectus” in the Act. Consequently, where a rights offer of listed securities is made in terms of section 96(1)(*d*), it is uncertain whether the statutory civil and criminal liability provisions[24] will apply to the rights offer, since it does not require a “prospectus”. Under the previous company-law regime, by contrast, a rights offer and all rights-offer documents were explicitly subjected to the full statutory civil and criminal liability regime.[25] Strangely, the current Act fails to do the same.

It is likewise unclear whether the statutory claim for compensation for false prospectuses[26] and the statutory criminal-liability provisions[27] apply to documents that are required by and are subject to the approval of the JSE or other relevant exchange. This applies, for instance, in the case of primary offers to the public of listed securities that are not IPOs. As stated above, uncertainty arises as a result of the absence of any definition of a “prospectus” in the current Act.

One may contrast this with the 1973 Act, which defined a “prospectus” broadly as “any prospectus, notice, circular, advertisement or other invitation, irrespective of whether it is done in non-electronic or electronic manner, offering any shares of a company to the public”. Its objective was to encompass all offer documents, even if not formally labelled as prospectuses. The extended definition of a prospectus in the 1973 Act served to ensure that all such offer documents were visited with the full legal

[24] Contained in ss 104–106 of the Act.

[25] By s 146A(5) of the 1973 Act.

[26] Under s 104 of the Act.

[27] Contained in s 106 of the Act.

consequences of failure to comply with the mandatory disclosure requirements.

The lacuna in the current Act is most regrettable. It is perhaps an unintended consequence or a drafting oversight. It must be rectified without delay, either by the courts or preferably by means of a legislative amendment. To deprive investors of the robust statutory remedies, and thus leave these investors to fall back on the inferior level of protection offered by the common-law claims for delictual damages for misrepresentation, is to jeopardise the public offerings regime set up by the Act.

The proposed Companies Amendment Act, presently still in the draft Bill stage,[28] presents a timely window of opportunity to remedy this defect by way of statutory amendment. This opportunity must not be missed.

2 4 Rights-issue litigation and securities litigation

The practical ramifications of this lacuna in the liability regime for public offerings in South African law must not be underestimated. There has been a global wave of securities litigation and shareholder class actions in recent years. One could well expect this trend to be mirrored in South Africa sooner or later.

The watershed moment in UK securities litigation was the rights-issue litigation against the Royal Bank of Scotland. A shareholder class action was brought against the Royal Bank of Scotland and its former directors by thousands of investors who had acquired shares in 2008 in the rights issue launched by Royal Bank of Scotland. Claims amounting to £4 billion were brought under section 90 of the Financial Services and Markets Act of 2000 (FSMA), on the grounds that the bank had omitted essential financial information from the prospectus that accompanied its £12-billion rights issue. Although the bank had raised £12 billion, it ended up collapsing a few months later, resulting in a £45-billion government bailout and a sharp drop in the bank's share price. Section 90 of the FSMA provides for civil liability for a false prospectus in UK law. It imposes a non-fraud-based liability on the issuer company and its directors, by providing that any person responsible for a prospectus is liable to pay compensation to investors who have acquired securities to which the prospectus applies, and who have suffered loss in respect of them as a result of any untrue or misleading statement or omission in the prospectus.

Although a settlement of £800 million was ultimately reached between the bank and claimants on the eve of trial, this rights-issue litigation case demonstrated that high-value shareholder class actions may successfully be pursued under the UK legal framework. This is instructive in South African law, where the broad equivalent of section 90 of FSMA is section 104 of the South African Companies Act of 2008.[29]

---

[28] Draft Companies Amendment Bill, 2021 GNR 586 in *GG* 45250 of 2021-10-01.

[29] MF Cassim and FHI Cassim *Law of Corporate Finance* 512.

Interestingly, since the Royal Bank of Scotland rights-issue litigation, securities group litigation has taken off in the UK, with claims being brought against other listed companies such as Tesco and Lloyds. This demonstrates that shareholders may, in practice, lodge claims against listed companies to recover losses suffered by them as a result of a fall in the price of their shares, often caused by a corporate scandal or other wrongdoing that is revealed to the market. The Tesco litigation concerned a class action brought under section 90A of the FSMA by two groups of institutional shareholders, after Tesco announced that it had overstated its profits guidance statements by more than £250 million, pursuant to which its share price dropped. The Tesco case, too, was eventually settled a few weeks before trial was due to commence, leaving a number of unanswered legal issues as to how the English courts will apply sections 90 and 90A of FSMA when untrue or misleading statements or omissions cause loss to investors.[30]

The Lloyds case, or *Sharp v Blank,*[31] was the first securities class action to be pursued to the end of trial in English law. It concerned the acquisition of HBOS by Lloyds during the 2008 financial crisis, which was approved by the company's shareholders on the negligent recommendation of the directors, as contained in a shareholder circular that made inadequate disclosure of the risks. Notably, the case was not founded on statutory liability under the FSMA, but instead on the common-law duty of the company and its directors in tort (or delict). The High Court dismissed the claims, on the ground that it was not convinced that the breaches had caused the losses claimed. The court observed that even if causation had been proved, no award of damages would have been available to the claimants under the reflective-loss principle. In the context of the South African liability regime for misleading prospectuses and offer documents, the Lloyds case demonstrates the difficult hurdles for shareholders who seek to pursue securities litigation at common law through the law of tort (or delict).

This trend of rising securities litigation applies not only in the UK, but also in Europe, Australia and Asia. In Germany and the Netherlands, for instance, investors sought compensation from Volkswagen for its failure to disclose its alleged manipulation of emissions tests, while similar cases were launched against Toshiba in Japan and AMP in Australia. In the USA, of course, securities litigation against listed companies has been long established. One wonders when this trend will be mirrored in South African law, particularly in the context of shareholder claims under section 104 of the South African Act for compensation for false and misleading prospectuses.

There are still a number of practical obstacles in South Africa, such as the relative dearth of third-party litigation funding and after-the-event insurance products. In contrast, shareholder class action claims against listed companies in the UK have in recent years become increasingly attractive to claimants. There are perhaps two main reasons for this. First, leading litigation funders in the UK view shareholder class actions as an area for

---

[30] See e.g., *SL Claimants v Tesco* [2019] EWHC 3315 (Ch).

[31] [2019] EWHC 3078 (Ch).

investment and they actively pursue potential shareholder class actions following corporate scandals or regulatory problems. Third-party litigation funding effectively shifts the burden of legal costs from the shareholder claimants onto the third-party funders. Secondly, the costs risks of shareholder claimants in the UK are further alleviated by after-the-event insurance products, which cover the claimants' liability to pay the costs of the defendant should the claim fail. Moreover, the Group Litigation Orders procedure[32] enables claimants to join a class action on an opt-in basis – a mechanism that was successfully used in the Royal Bank of Scotland rights-issue litigation in which thousands of claimants were involved.

2 5 The section 96(1)(*c*) safe harbour

Turning to the second safe harbour for rights offers in the South African Act referred to under heading 2.2 above, section 96(1)(*c*) creates an exemption for a non-renounceable rights offer made only to existing holders of the company's securities, or persons related to existing holders of the company's securities. Since such rights offers are non-renounceable, they may be taken up by the recipients only; they cannot be made available to persons other than those to whom the offer was made. The reason that non-renounceable rights offers under section 96(1)(*c*) are deemed not to be public offers and are therefore exempted from the prospectus requirement seems to be that the company is seeking capital from its current shareholders who, in theory, would already be well versed in the company's affairs.

Disclosure is made by means of filing with the Companies and Intellectual Property Commission letters of allocation conferring the rights to subscribe for shares in the rights offer, accompanied by all the documents required by the Act.[33] The filing and registration of these documents ensures that they are available to the public for inspection. On pain of criminal and civil sanctions, letters of allocation relating to unlisted securities may not be issued, distributed or delivered to the shareholders unless accompanied by all the documents that are required and have been filed.[34] Every letter of allocation must state on its face that a copy of it, together with copies of all other requisite documents, has been filed with the Companies Commission. The letter of allocation must also include a statement that copies of all the documents referred to in regulation 49(1) of the Companies Regulations are available, and must set out the manner by which the copies may be obtained.[35]

In short, one must distinguish between rights offers in listed and unlisted companies. Rights offers of unlisted shares must be non-renounceable in terms of section 96(1)(*c*) in order to be exempt from the publication of a prospectus, whereas rights offers of listed securities are exempt whether or

[32] In Part 19 of the UK Civil Procedure Rules.
[33] S 99(4) of the Act read with reg 49 of the Companies Regulations. See also reg 55.
[34] S 99(4)(*a*) of the Act.
[35] Reg 49(3) of the Companies Regulations.

not they are renounceable, in terms of section 96(1)(*d*). In practice though, rights offers launched by listed companies are invariably renounceable, and are typically offered by means of renounceable letters of allocation.

A letter of allocation, in simple terms, is an offer or invitation to take up the shares. The Act defines a letter of allocation as any document conferring the right to subscribe for shares in terms of a rights offer.[36] When a letter of allocation is renounceable, the existing shareholders of the company are given the choice to subscribe for the new shares themselves, or to renounce and sell their rights for cash. In other words, a shareholder may renounce and transfer his or her entitlements to the new shares to other investors. These subscription rights may be renounced either in whole or in part. Renounceable letters of allocation (or nil paid letters of allocation) have a value and may be traded on the market. The value of a renounceable right is an amount up to the difference between the market price of the shares and the issue price of the shares in the rights offer.[37] Existing shareholders who do not wish to participate in the renounceable rights issue consequently have the option to sell these rights to third parties. They have a third option too: to simply do nothing and allow the rights to lapse – in which case their shareholding will inevitably be diluted.[38]

In contradistinction to a renounceable rights issue, the rights in a non-renounceable rights issue are not transferable. The subscription rights cannot be transferred to third parties, nor can they be sold in the market. If they are not exercised by the shareholders, non-renounceable rights simply lapse.

It must be emphasised that the policy choice on rights offers in terms of section 96(1)(*c*) and (*d*) does not constitute full exemption from disclosure – it is instead reduced disclosure. The policy of reduced disclosure for rights offerings may be contrasted with other safe harbours in the Act that offer a full exemption from disclosure, such as the sophisticated-investor exemption or the professional-investor exemption.[39] To elaborate, although section 96(1)(*c*) and (*d*) rights offers do not need full disclosure by means of a prospectus, they are not completely exempt from any disclosure; reduced disclosure is made by means of the documents that are required to be filed or issued in connection with section 96(1)(*c*) and (*d*) rights issues in terms of the Act and the Companies Regulations.

A rights issue must be distinguished from a private placing. While both are methods used by companies to raise capital by means of the issue of shares, there are significant differences between the two methods of equity fund-raising. A private placement involves, not a public offering, but rather a private offering of securities to a small group of selected investors, such as wealthy individual investors, banks, pension funds and other institutional investors. Private placements are quicker and less costly than public offerings. Since a private placement is designed not to be an offer of

[36] S 95(1)(*f*) of the Act.

[37] MF Cassim and FHI Cassim *Law of Corporate Finance* 430–431.

[38] See further below.

[39] Contained in s 96(1)(*b*) and s 96(1)(*a*)(i)–(vii), respectively.

securities to the public at large, it does not require a sales pitch to attract the public, and may be exempt from the requirement of a prospectus and the other compliance hurdles incumbent in public offerings. A private placement of securities with sophisticated investors or with professional investors falls within the ambit of the excluded list of offers or safe harbours[40] that are not offers to the public and do not require a prospectus.[41] This is a complete or full exemption, which is a distinct advantage that private placings have over rights offers. Unlike the safe harbours for rights offerings under section 96(1)(*c*) and (*d*), which are subject to reduced disclosure, the Act does not regulate private placements at all, leaving disclosure in private placings to be entirely regulated by contract.

3 RIGHTS ISSUES IN UNITED KINGDOM AND AUSTRALIAN LAW

3 1 United Kingdom

In the United Kingdom (UK), controversy surrounded the question whether rights issues of securities that are already publicly traded should be exempt from a prospectus in the first place. It was contended, on the one hand, that a full prospectus may be an unnecessary duplication in view of the amount of information that is already publicly available, as a result of the continuing disclosure obligations of listed companies. On the other hand, it was regarded as equally important not to "empty prospectuses of their substance" because that would defeat the objective of investor protection.[42]

It was not until as recently as 2019 that rights issues in the UK benefitted from reduced disclosure requirements. This may be contrasted with South African law, which has exempted rights offerings from a full prospectus for many decades. While the Prospectus Directive prescribed by the European Union[43] initially rejected the approach that exempts rights issues, the Prospectus Regulation,[44] which became effective in July 2019, provides for a simplified disclosure regime for rights issues subject to the condition that the issue must relate to shares that have at least an 18-month track record on the market.[45] Despite Brexit, the Prospectus Regulation continues to be in force in the UK as a domestic law. It must be emphasised that the policy choice on rights issues in the UK is by no means a policy of full exemption; it is, rather, one of reduced disclosure or simplified disclosure. This, too, is the case in South African law.

The UK is now making strides towards a new regime for prospectuses and public offers. In December 2022, an illustrative draft statutory instrument

---

40 Contained in s 96(1)(*a*) and (*b*) of the Act.

41 MF Cassim and FHI Cassim *Law of Corporate Finance* 425.

42 European Securities and Markets Authority ESMA/2011/323 par 262.

43 Directive 2003/71 on Prospectuses [2003] OJ L345/64 as amended by Directive 2010/73 [2010] OJ L327/1.

44 Reg 2017/1129 [2017] OJ L168/12.

45 Art 14 of the Prospectus Regulation.

was published by HM Treasury on the proposed reforms of the public offers and admissions to trading regime; it is intended to replace the UK Prospectus Regulation and to introduce a reformed regulatory framework. Some of the key features of the draft legislation are that it proposes to give the Financial Conduct Authority the power to redesign prospectus contents, and that prospectuses will be required in fewer instances. There will also be a split between the regulation of offers to the public and the regulation of admissions to trading, as opposed to the current UK framework where they are regulated together but with different exemptions.

In the arena of public offerings of securities, the current requirement (to publish a prospectus for public offerings unless it falls within one of a number of exemptions) will be replaced with a general prohibition on public offerings, subject to exemptions. Some of the current exemptions will be retained, such as the case of an offer to professional or qualified investors, or an offer to fewer than 150 persons (who are not qualified investors). New exemptions proposed to be added include offers of securities of a class that are already, or will be, admitted to trading on regulated markets, and offers to existing equity shareholders of unlisted companies on a pro rata basis – that is, rights issues. Interestingly, these rights issues by unlisted companies must be made to shareholders on a pro rata basis in order to qualify for the exemption – in contrast with the rights-issue exemption for unlisted companies contained in the South African statutory provisions. As discussed above, it appears from the South African Act[46] that a rights offer need not be pro rata or in proportion to shareholders' existing holdings in an unlisted company in order to qualify for the section 95(1)(*c*) safe harbour. Where a public offer is permitted, there will be a general requirement in the proposed new UK legislation that material information must be disclosed in the prospectus, if one is required, or otherwise must be disclosed to all other investors to whom the offer is addressed.

3 2 Australian law

In a similar vein to South African law and current UK law, Australian law does not require a full prospectus for a rights offer of listed shares. The approach adopted in the Australian legislation is, however, a more liberal one. The Australian regime on corporate fund-raising and disclosure in offers of securities is more complex than its South African equivalent.

The Australian Corporations Act 2001 provides that an offer of securities requires disclosure to investors unless sections 708, 708AA and 708A state otherwise.[47] Consequently, even an offer to one person only requires disclosure unless an exemption is applicable. Many, though not all, of the exemptions contained in the Australian statute are broadly similar in nature to the safe harbours in South African law. The main exemptions are those for small-scale personal offers, sophisticated investors, wealthy investors, experienced investors and professional investors, offers to parties within the

---

46 In terms of s 95(1)(*l*) of the Act.

47 S 706 of the Australian Corporations Act 2001.

company such as corporate insiders, offers for no consideration, and offers to existing security holders, which includes bonus issues of fully paid shares.

As regards the onus of proof, it has been held in several Australian cases that the issuer company that seeks to raise capital under the benefit of an exemption bears the onus of proving that the exemption applies.[48] However, more recently, in *Gore v ASIC*,[49] a contrary view was expressed – that the onus of proof does not lie on the contravener, but he or she has an evidentiary burden to raise the issue that an exemption may apply. In South African law, the issue of the onus of proof of an exemption arose, but was left open, in *S v National Board of Executors Ltd*.[50]

Regarding exemption for rights issues in Australian law, a rights issue of quoted or listed securities does not require disclosure to investors by means of a prospectus or disclosure document, provided that four conditions have been satisfied:[51] first, the offer must be made to all existing holders in the offer class; secondly, the offer must be pro rata; thirdly, the terms of the offer must be the same; and fourthly, the issuer must give the market operator a "cleansing notice". When all the conditions are fulfilled, the rights offer may be made without the need for any disclosure documents to be lodged with the Australian Securities and Investments Commission (ASIC). The "cleansing notice" must state that the company will offer the relevant securities for issue without disclosure to investors under Chapter 6D, set out any information that is "excluded information",[52] and state the potential effect that the issue of the securities will have on the control of the company and its consequences. The rationale for the exemption for rights issues[53] is that investors' interests will be protected through the original prospectus coupled with continuous disclosure obligations imposed on listed companies, which will enable them to make an informed decision on the rights issue. Instead of a prospectus or disclosure document, all that is required is a "cleansing" notice.

This liberal approach, which permits listed companies to make rights issues without any disclosure documents, on condition that the company submits a notice to the market operator, was adopted in 2007.[54] Prior to 2007 though, the legal treatment of rights issues in Australian law was broadly in tandem with the current approach in the UK and South African

[48] *ASIC v Axis International Management Pty Ltd* (No 5) (2011) 81 ACSR 632; *ASIC v Great Northern Developments Pty Ltd* (2010) 79 ACSR 684; *ASIC v Cyclone Magnetic Engines Inc* (2009) 71 ACSR 1.

[49] (2017) 118 ACSR 58.

[50] 1971 (3) SA 817 (D).

[51] In terms of s 9 read with s 708AA of the Australian Corporations Act 2001.

[52] "Excluded information" is information that has been excluded from a continuous disclosure notice, and that investors and their professional advisers would reasonably require for the purposes of making an informed assessment of the assets and liabilities, financial position and performance, profits and losses, and prospects of the company, or the rights and liabilities attaching to the securities.

[53] Explanatory Memorandum to the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 (Explanatory Memorandum).

[54] With the commencement of the Corporations Legislation Amendment (Simpler Regulatory System) Act of 2007.

law, insofar as a policy of reduced disclosure applied. A disclosure document was required for rights issues prior to 2007, but listed companies could take advantage of the reduced disclosure requirements under the special prospectus rules for continuously quoted securities.

Interestingly, the reason for the liberalisation of rights offers in Australian law is that the prospectus or disclosure requirement had resulted in rights issues as a fund-raising mechanism being superseded by other forms of capital-raising with less onerous disclosure requirements, such as placements of shares with institutional investors – with the consequence that small shareholders were being disadvantaged.[55] Whether or not such a policy shift would be advisable in the South African socio-economic and regulatory environment is debatable and is open to question.

4 BENEFITS AND DRAWBACKS OF RIGHTS OFFERS

A company commonly launches a rights offer in order to raise new equity capital. A rights issue is a favourable mechanism for a company to raise capital to operate its business without any attendant increase in debt. By inviting its current shareholders to acquire more of the company's shares in a rights issue, a company essentially taps its shareholder base for finance, so that it does not need to raise the necessary funds by means of borrowing or loan capital. The advantage of equity capital-raising over loan capital, from the company's perspective, is that the payment of interest on loan capital to debt holders, and the repayment of the principal amount on maturity, are fixed claims against the company that must be paid regardless of whether the company is profitable. The company may therefore prefer equity funding in order to avoid the fixed payments of interest that are inherent in debt funding.

4 1 Reasons for rights offers

It is not only companies in financial distress that seek to raise capital by means of a rights issue to their existing shareholders. Even companies with a healthy balance sheet or a smooth cash flow may choose to do so. Such companies may require a large sum of fresh capital for a takeover of a competitor, or to acquire new assets or new technology, or for the growth and expansion of the company's business. In other cases, however, rights issues are offered by cash-strapped companies when debt funding is not available or is too expensive, and when the company has no other viable avenues for finance. The company may be a troubled one that seeks to raise funds in a rights issue in order to use the newly raised finance to pay off its debts to its bankers and lenders and thereby return to financial health.

In practice, a rights offer of shares is more likely to be accepted by the shareholders of a company that is experiencing good growth. It is generally a company's performance, growth and returns, and the value of its shares

---

[55] Explanatory Memorandum par 5.6.

that attract shareholders to take up the opportunity to subscribe for the new shares offered by the company at a discounted rate in a rights offer. The shareholders, as stated above, are free to take up these subscription rights or to reject them. For existing shareholders, rights offers present the advantage of their being able to acquire more shares in the company below the market price; of course, this is of benefit to the shareholder only if the company is exhibiting growth or the potential for growth.

When a company finds itself with a serious debt problem and is under severe pressure to deleverage, it may decide to embark upon a rights offer to raise its equity capital and service its debts. By means of a rights offer, a company experiencing a shortage of cash may build a new balance sheet and improve its debt-equity balance. A recent, prominent case in point is the JSE-listed technology group EOH Holdings Limited ('EOH'), which approached its shareholder body for cash when it was on the brink of technical insolvency to resolve the legacy debt issues that it had been battling. EOH was almost destroyed by alleged corrupt dealings between several former employees and directors who were allegedly involved in tender fraud and irregular dealings with public sector officials in state organisations such as the South African National Defence Force and the Department of Water and Sanitation. In January 2023, EOH proceeded to raise equity capital through a R500-million rights offer.[56]

A company's leverage or gearing ratio refers to the ratio of debt to equity in a company. In simple terms, a company raises debt finance by borrowing, and it raises equity finance by the issue of more shares. In a nutshell, the impact of leverage is that it enhances shareholders' returns when the business prospers; but, conversely, it amplifies their risk when the business performs poorly.[57] The drawback of debt funding is that the risk of corporate insolvency rises when there is too much debt in a company's capital structure, since the payment of interest and the repayment of the principal amount constitute fixed claims. From the perspective of the external lender, banks and other financial institutions may be reluctant to extend credit to a highly leveraged company since there is a greater risk. Thinly capitalised companies may be viewed in a negative light by external lenders from whom they seek loans or credit; when a company's own shareholders do not have the confidence to invest in the company's equity, external lenders may refuse to fund the company. It was considerations of this nature that motivated the rights offer made by EOH.

A second notable example of a recent rights offer aimed at deleveraging a debt-laden company was that proposed by the Nampak group, South Africa's largest manufacturer of packaging and cans. Nampak Limited (Nampak) in late 2022 to early 2023 (unsuccessfully) proposed to de-gear by raising up to R2-billion in a rights issue. The bulk of the equity capital raised from its shareholders was intended to be used to settle R1.35 billion of its

[56] Rubenstein "Press Release: EOH Announces Final Terms of Rights Offer" (19 January 2023) https://www.eoh.co.za/today-eoh-released-the-final-terms-of-its-rights-offer/ (accessed 2023-04-03).

[57] MF Cassim and FHI Cassim *Law of Corporate Finance* 9–12.

massive debt of R5.2 billion owed to bankers and lenders, and to thereby de-gear the company.[58]

When a rights issue is driven by a liquidity crisis (as in the case of the rights offers of both EOH and Nampak) rather than plans for the company's growth and expansion, there is a risk of the rights issue having a negative impact on the company's reputation. The market may interpret the rights issue as a warning sign that the company is in trouble, and investors may exit by selling their shares. This could result in share prices plunging. In EOH's case, for instance, the share price fell by 30 per cent ahead of the rights offer, after details of the planned rights issue were released. In Nampak's case, the market was rattled by the large size of the proposed rights issue (up to R2-billion) in comparison to Nampak's market value, with the result that the share price plummeted by nearly a third.[59] This occurred notwithstanding that a chunk of the capital to be raised in the rights offer was intended for the upgrade of Nampak's beverage can line, so as to take advantage of the strong market demand for beverage cans.

Ultimately, the capital-raising efforts of EOH met with success, with the R500-million rights offer being oversubscribed by its shareholders. Nampak, in contrast, failed to secure shareholder approval of its proposal to raise up to R2 billion in its rights issue, with the extraordinary general meeting in January 2023 being adjourned.[60] The Nampak shareholders favoured a reduction in the quantum of the proposed rights offer in order to protect shareholder value. Rights offers tend to be dilutive.

The rights offers made by EOH and Nampak illustrate the principle that the purpose of a rights issue is of cardinal importance. In deciding whether to participate in a rights issue, shareholders will consider, among other things, the terms of the rights issue as well as the reasons for and the circumstances of the rights issue. As a matter of strategy, there must be a compelling reason for the company to make a rights offer. Savvy shareholders know full well that to acquire additional shares at a discount is not necessarily always a bargain or an advantage. Sophisticated shareholders will consider the number of shares they can acquire, the discount offered on the shares and the financial health of the company.

---

[58] Wilson "Nampak Crashes Nearly a Third After Saying It's Looking to Tap Shareholders for R2bn" *News24* (1 December 2022) https://www.news24.com/fin24/companies/nampak-crashes-nearly-a-third-after-saying-its-looking-to-tap-shareholders-for-r2bn-20221201 (accessed 2023-04-03).

[59] Daily Investor "Investors Dump EOH Ahead of Rights Issue" (21 November 2022) https://dailyinvestor.com/technology/5769/investors-dump-eoh-ahead-of-rights-issue/ (accessed 2023-04-03); Wilson https://www.news24.com/fin24/companies/nampak-crashes-nearly-a-third-after-saying-its-looking-to-tap-shareholders-for-r2bn-20221201.

[60] Sharenet, "EOH Holdings Limited Results of the Rights Offer and Directors' Dealings" (13 February 2023) https://www.sharenet.co.za/v3/sens_display.php?tdate=20230213080000&seq=3 (accessed 2023-04-03); Gumede "Nampak Debt Advisers Gallery Swells as Lenders Add Own" *Business Day* (7 March 2023) https://bd.pressreader.com/article/281857237749649 (accessed 2023-04-03).

4 2 Dilution

A key drawback of a rights issue for shareholders is dilution – both in the sense of value dilution and control dilution. From the viewpoint of shareholders, a rights issue means that they must either invest more money in the company or face significant dilution in their shareholdings.

To elaborate, the raising of capital through the fresh issue of additional shares in a company is, *in general*, dilutive. When new shares are issued to third parties or outside investors, or where shares are offered only to some but not all of the existing shareholders, or where they are issued to existing shareholders but on a disproportionate basis to their existing holdings, this could adversely dilute the proportional interests held by existing shareholders in the company. It could result in a dilution of the shareholders' control rights or their voting power in the company (since they now have control over a smaller percentage of the votes), or it could dilute the financial rights of existing shareholders (if the new shares are issued for an amount below their current market value).[61] In a *private placement* of shares, for instance – where shares are offered to a limited pool of selected, high-profile investors, but are not offered to all the company's current shareholders as would be the case in a rights offer – the existing shareholders of the company suffer dilution as a result of the private placement.

However, where a company raises capital through the issue of shares in a *rights offer*, the advantage to shareholders who choose to take up these rights is that they are able to protect their shareholding from dilution. A rights offer is usually proportional. In other words, existing shareholders are invited to subscribe for new shares pro rata to their current shareholding in the company, so that by taking up the new issue, the shareholders preserve their proportional interests in the company and thereby protect their investments from dilution. Each shareholder owns more shares after the new issue, but still holds the same proportion of the company's total equity.[62] In this way, dilution is avoided. Control of the company remains in the hands of the existing shareholders – in contrast with a private placement of shares with outsiders. This is a significant benefit of a rights issue over a private placement from the perspective of the current shareholders of the company.

However, for existing shareholders who choose not to subscribe for the rights offer, there may be dreadful dilution of their equity stakes in the company. As such, a rights offer tests the faith and confidence that investors have in the company and its management to create value for shareholders. In the case of EOH's rights offer, for example, more than 90 per cent of the company's shareholders took up their rights, with requests for additional allocations.[63]

Importantly, it should be noted that after a rights issue has been completed the company's share price is very likely to drop. It is, of course,

---

61 MF Cassim and FHI Cassim *Law of Corporate Finance* 153–154.

62 MF Cassim and FHI Cassim *Law of Corporate Finance* 428–429.

63 Sharenet https://www.sharenet.co.za/v3/sens_display.php?tdate=20230213080000&seq =3.

still the same company but, since more shares are now in issue to the market, the value of the shares is diluted. This could result in a decrease in earnings per share (EPS) and a reduction in dividends or return on equity. Nonetheless, depending on how the company uses the fresh capital raised in the rights issue, the rights issue may in the long run result in gains for the shareholders, despite the dilution in the value of the shares.

4 3 Discount

From the shareholders' vantage point, rights offers give them the chance to subscribe for extra shares in the company at a reduced rate. Rights issues by listed companies are generally priced lower than the market price of the shares. The reason for the discount is to make the offer attractive to shareholders and to encourage them to take up the fresh shares. The subscription price of EOH's rights offer, for instance, was set at a discount of approximately 30 per cent to the theoretical ex-rights price (TERP) and a discount of approximately 58 per cent to the EOH share price.[64] This is the average for rights offers of that size. By subscribing for the new shares, the shareholders gain the benefit of the discount to the market price.

By way of an example, assume that Investor A holds 10 000 shares of X Ltd of R20 each. To raise capital, X Ltd announces a rights issue for current investors at a discount of 30 per cent. It is a one-for-two rights issue, which permits current investors to subscribe for one new share for every two existing shares. This means that A could acquire up to 5 000 additional shares for R14 each, which amounts to a total discount of R30 000. Investor A thus increases his exposure to X Ltd's shares and does so at a reduced price. This brings A's average cost of acquisition for his 15 000 X shares to R18 per share (that is, 10 000 shares at R20 each and 5 000 shares at R14 each). Alternatively, Investor A could decide not to take up his rights at all, in which case his shareholding would be diluted.

Investor A's third option, which applies only in circumstances where the rights are renounceable, is to renounce and sell his rights to other investors for cash or to trade them on an exchange (if the issuer company is listed and the rules of the exchange make provision for rights trading on the market). Renounceable letters of allocation or "nil paid rights" have a value, as discussed above. They are termed "nil paid rights" since the shareholder has paid nothing for them. "Nil paid rights" may generally be sold for an amount up to (but usually less than) the difference between the market price of the shares and the subscription price applicable to the rights issue – or to be more accurate, an amount equivalent to the difference between the ex-rights price and the subscription price. The shareholder's ability to sell to a third party his or her rights to buy the new shares is a further advantage of a (renounceable) rights offer. It enables the shareholder to avoid significant value dilution without having to participate in the rights issue. In practice though, there is typically some degree of dilution, in order to encourage the

---

[64] Sharenet "EOH Holding Limited Finalisation Announcement in Respect of the EOH Renounceable Rights Offer" (19 February 2023) https://www.sharenet.co.za/v3/sens_display.php?tdate=20230119105000&seq=33&scode=EOH (accessed 2023-04-03).

third party to purchase the nil paid rights. Rights issues may thus be a risk for a company, to the extent that they test the confidence of shareholders in the growth prospects of the company.

A rights offer may in some cases result in more concentrated shareholdings for some investors. In other words, some of the company's existing shareholders may become major controllers of the company. From the shareholders' perspective, this is a drawback of rights offerings. A portion of the rights offer may be unsubscribed. A change of control may result from other circumstances too, as demonstrated by the controversial rights offering launched by JSE-listed company Tongaat Hulett Limited, South Africa's largest producer of sugar.

Tongaat Hulett proposed a controversial and highly dilutive rights issue of R5-billion in 2022 in order to raise capital for the business to reduce its massive debt levels, following years of debt burden, alleged financial mismanagement, and a huge accounting scandal that almost destroyed the company. The rights issue was to be partially underwritten (to the amount of R2 billion) by the controversial Mauritian-domiciled financier Magister Investments, which was a minority shareholder holding approximately 0,15 per cent of the shares in Tongaat Hulett, provided that a waiver was granted by the Takeover Regulation Panel (TRP) to exempt Magister from making a mandatory offer to minorities. The rights offer was strongly opposed by other minority shareholders who questioned the governance and financial history of Magister Investments, and raised concerns about the control Magister would wield in Tongaat Hulett,[65] bearing in mind that it was to hold 35–60 per cent of Tongaat Hulett's shares pursuant to the rights issue.

Ultimately, the underwriting agreement with Magister Investments was terminated, after the TRP's waiver ruling was struck down on review. An underwriting arrangement is often a significant de-risking mechanism, particularly in rights offers of this magnitude. The result of the termination of the underwriting agreement was that Tongaat Hulett's rights offer was brought to a halt. Sadly, a few months later in October 2022, when it was unable to service its debt to its lenders and it was denied additional funding, Tongaat Hulett went into business rescue.[66]

4 4 Underwriting

An advantage of a rights issue over an IPO or a full-scale public offering is that a rights issue generally enables a company to raise capital without incurring the expense of underwriting fees. A rights issue is a quicker and less costly mechanism for capital-raising than an offer of shares to the public, particularly since a rights offer is typically exempt from the publication of a registered prospectus, as discussed above. The company also saves a

---

65 Cokayne "Hulett Shares Surge" *The Citizen* (14 July 2022) https://www.pressreader.com/south-africa/the-citizen-gauteng/20220714/281964611438224 (accessed 2023-04-03).

66 Tongaat Hulett Limited "Tongaat Hulett Development Enter Business Rescue in South Africa" (27 October 2022) https://www.tongaat.com/tongaat-hulett-limited-tongaat-hulett-development-enter-business-rescue-in-south-africa/ (accessed 2023-04-03).

substantial amount of money on advertising costs and underwriting costs when it opts for a rights issue rather than an offer of shares to the public at large. Unlike a full-scale public offering though, there is a limit to the amount of money that can be raised in a rights issue. Capital-raising in a rights offer is limited to the amount that existing shareholders are willing to invest.

In some cases, however, a company may decide to have its rights issue underwritten by an investment bank or financial institution. Underwriting is not a mandatory requirement, but it is an important de-risking device – as illustrated by the aborted rights issue of Tongaat Hulett following the termination of its underwriting agreement with Magister Investments. The concept of underwriting is, however, an elusive one. As stated in the Australian case *Aberfoyle Ltd v Western Metals Ltd,*[67] there are at least three different identifiable types of underwriting in practice. Be that as it may, the role of the underwriter, at least in traditional underwriting, is to ensure that the rights issue is a success and to guarantee that the capital sought by the company will be raised. In terms of the underwriting agreement, the underwriter typically agrees, in return for a significant commission, to take up any shares or a specific portion of the shares that are not subscribed for by existing shareholders. Underwriters, in practice, may make arrangements to pass on some or all of their obligations to sub-underwriters, such as institutional investors. Underwriting is quintessentially a form of insurance. It eliminates the risk of a rights offer being undersubscribed, and thereby protects the company against the failure of its equity capital-raising effort.[68]

EOH's rights offer, for instance, was de-risked by three underwriting agreements in terms of which the underwriters collectively committed themselves to subscribe for any shares that were not taken up by EOH's existing shareholders. These underwriting agreements, coupled with irrevocable undertakings from shareholders holding approximately 30 per cent of EOH's issued shares, to follow their rights in full, effectively guaranteed that the R500 million sought by EOH would be raised.[69] The downside, however, is the additional expense occasioned by underwriting agreements.

5 CONCLUSION

A rights issue is a useful mechanism for a company facing a liquidity crisis to tap its existing shareholders for funds. Several benefits as well as drawbacks pertain to rights issues. The fact that a company makes a rights offer does not necessarily mean that the company is a sinking ship, or that it is facing financial turmoil but is unable to borrow any more money. Even financially healthy companies offer rights issues in order to source fresh capital for the growth and expansion of the company. Where the rationale for a rights issue is business expansion rather than debt repayment, the future financial benefits to shareholders may outweigh the drawback of share

---

67 (1998) 28 ACSR 187.

68 MF Cassim and FHI Cassim *Law of Corporate Finance* 404–405.

69 Sharenet https://www.sharenet.co.za/v3/sens_display.php?tdate=20230119105000&seq=33&scode=EOH.

dilution in the rights issue. Savvy investors are aware that a rights offer is not always a chance to grab a bargain by acquiring new shares in the company at a discounted price. Astute investors consider factors such as the terms of the rights issue, the discount offered, the number of shares they can acquire, and the circumstances and rationale for the rights offer. It generally is the company's performance, growth and returns, and the value of the company's shares that induce shareholders to take up their subscription rights or to reject them. Rights offers tend to test the faith of shareholders in the company and its board of directors to create shareholder value.

When a rights offer is carefully structured so as to qualify for one of the safe harbours contained in section 96(1)(*c*) or (*d*), the issuer company will conveniently be exempted from the expense and administrative burden of publishing a registered prospectus. This is an important advantage. A policy of reduced disclosure, broadly comparable to the UK approach, has been adopted in relation to section-96(1)(*d*)-rights offerings under the South African Companies Act of 2008 – as opposed to the more liberal policy of full exemption from disclosure (on condition that a cleansing notice is provided) that now applies to rights issues in Australian law.

What is disappointing is the lacuna in the South African prospectus liability regime; the regime fails to extend to false and misleading rights offer documents, and other disclosure documents that are not formally labelled "prospectus". This fails sorely in doing justice to the founding value of investor protection in public offerings, and undermines the public offerings regime set up in Chapter 4 of the Act. The practical ramifications of this shortcoming in the South African Act must not be taken lightly – particularly in light of the wave of shareholder class actions that has been sweeping the globe, and the seminal rights issue litigation launched against the Royal Bank of Scotland in the UK.

This glaring defect in the liability regime for public offerings in South African law must be rectified without delay by legislative amendment. The proposed Companies Amendment Act (currently still in the draft Bill stage)[70] presents an opportune occasion to do so. The opportunity, it is submitted with respect, should not be missed.

[70] Draft Companies Amendment Bill, 2021 GNR 586 in *GG* 45250 of 2021-10-01.