Hunton & Williams
Client Alert

December 2010

Cash in the Box

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Quoted companies are turning to the cash box structure more than ever before as a way of raising capital quickly and without the need for a shareholder meeting. Where such transactions are transparent and the reasons for them are communicated to investors, institutions are increasingly supportive of this expedient fundraising method. Hunton & Williams have assisted on several such transactions in the past year.

English companies and overseas companies quoted on the London stock exchanges are subject to various restrictions when seeking to undertake an equity fundraising. Most will be subject to pre-emption provisions, whether under statute or their constitution, which require them to offer their shares pro-rata to existing holders in the event of an equity issue. In addition, investor protection committees such as the Pre-Emption Group suggest that any disapplication of such pre-emption rights should be limited to 5% of the company's issued share capital in any one year and that only 7.5% should be issued under such disapplication in any rolling three-year period. These recommendations are intended only for companies on the Official List but are also accepted as best practice for AIM companies. While this annual 5% pre-emption disapplication is useful when quickly raising smaller amounts, it does not allow a company to raise significant amounts of cash relative to its existing market capitalisation.

A company is therefore likely to need to seek approval from its shareholders to waive their pre-emption rights if it wants to raise a substantial amount of money, or otherwise carry out a more expensive rights issue to all of its shareholders. However, in difficult economic times, where capital is at a premium and investor appetite is fleeting, the ability to act quickly can be the difference between success and failure. With markets still turbulent, given recent macro-economic events across the Eurozone, a company's share price could fluctuate wildly or a speculative acquisition opportunity could disappear during the time it takes to call and hold a general meeting of the shareholders. There is also often no guarantee that they will approve the disapplication of pre-emption rights.

To address these issues many companies have turned to the cash-box structure. Originally designed to assist acquisitions where the vendors wanted cash and the company wanted to use its capital as currency, but where a vendor placing was not possible due to timing or logistical reasons, the cash box placing is a series of legal steps designed to bring a fundraising outside the ambit of pre-emption rights. Almost all pre-emption provisions, be they statutory or constitutional, will have a carve-out stating that they do not apply where the issue of shares is for "non-cash consideration" (which includes other shares). The cash box is a means of structuring a placing such that it becomes a share-for-share exchange between the issuer company ("**Issuer Plc**") and its investment bank which transfer to it shares in a specially incorporated vehicle ("**SPV Ltd**"). In short, SPV Ltd issues its preference shares to the investment bank acting on Issuer Plc's behalf. In return the investment bank pays SPV Ltd cash it has collected from investors to whom it has promised to issue shares in Issuer Plc. The investment bank then transfers these preference shares to Issuer Plc in return for which Issuer Plc issues shares in itself to the investors, thereby completing the placing. SPV Ltd, whose only asset is the cash it received from investors, is then a wholly-owned subsidiary of Issuer Plc.

Although the logistical steps sound complicated, a cash box transaction can actually be effected within as little as five business days from its inception. For AIM companies it can be done using no more than an investor presentation and subsequent announcement (not including the various legal documents that will be required).

This structure is not quite so useful for companies on the Official List as they are further constrained by the Prospectus Rules which require a company to produce a prospectus if it proposes to apply for admission to trading of shares equal to 10% or more of its existing issued share capital. However, this does not apply to AIM companies (AIM is not a "regulated market" for the purpose of the Prospectus Rules) so they are able to use the cash box to issue as many shares as they are able under their existing shareholder authorities, usually 33% of issued share capital per year.

Nothwithstanding that the cash box structure seemingly permits the dilution of existing shareholders, investor protection committees have generally been sanguine about its use. Indeed, such is their popularity that cash boxes are increasingly used for generic purposes in cases where the rationale for which is sound. For example, Tullow Oil plc raised £400 million in February 2009 by cash box to finance its ongoing operations. In a less high profile example, AIM-listed Augean plc issued 52% of its share capital under a cash box structure in September 2009 as part of a rescue fundraising. Drax Group, Soco International, Logica, Balfour Beatty and most recently, Hunton & Williams client, Faroe Petroleum plc have all also taken advantage of the cash box structure. In such circumstances, there has been a developing trend of companies and advisers consulting investor protection groups prior to use of a cash box, just as a matter of courtesy and to allay the possibility of any negative comment.

There has also been much legal commentary over the use of cash boxes, as some practitioners have suggested that it may be viewed as a disingenuous use of valid legal systems. However, no challenge has yet been brought and the prevailing view amongst counsel is that the structure is a legitimate use of various legal steps and, in the absence of fraud or breach of duty, any challenge to it attempting to "lift the corporate veil" or suggest that it may otherwise be invalid, would not be successful. Indeed, the sheer number of companies who have successfully utilised the structure illustrates its broad acceptance by shareholders, regulators and advisers alike.

It appears therefore, that the cash box structure is here to stay and, provided it is executed correctly and with due deference to existing shareholders, can be an effective way of quickly and painlessly raising cash.

Hunton & Williams' London Office has acted on several cash box transactions in the past year. Should you require any further information or wish to discuss this structure in more detail, please contact Paul Tetlow, James Green or Christopher Raggett at this Firm.