FURTHER
TECHNICAL ISSUES
WITH THE
TAKEOVERS CODE

A CONSULTATION PAPER ISSUED BY THE TAKEOVERS PANEL

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INTRODUCTION

1. The Takeovers Panel has the function, among other things, of keeping under review the law relating to takeovers of Code companies and recommending to the Minister of Commerce any changes to that law that the Panel considers necessary.[1]

2. The Takeovers Code came into force on 1 July 2001. The Panel has administered the Code since then and from time to time becomes aware, through its interaction with the market, of problems, often of a minor technical drafting nature, which leave the Code less efficient and effective than it could be.

3. The Panel is committed to having the Code work well. To this end, the Panel is undertaking a 'low policy content' review of the Code, and is proposing a number of amendments, mostly to address technical anomalies. The proposals are of principal interest to practitioners actively involved in the takeovers market. The review does not extend to the fundamental policy underlying the Code.

4. This paper is the fourth in a series of four consultation papers that have been issued by the Panel on 'technical' issues with the Code. The first paper, in August 2009, related to the Code's regulation of partial takeover offers. The second paper, in June 2010, covered a range of issues identified in Parts One to Five of the Code. The third paper, in December 2010, related to one aspect of the second paper which required further public consultation; that was, the effect of certain conditions in hostile takeovers. The third paper also included a proposal to reinstate the Panel as arbiter of disputes regarding the recovery of takeover costs by target companies, following a High Court decision which held that the Panel does not currently have that power, [2] and, finally, a proposal to remedy an inadvertent change to the definition of 'Code company' that occurred in 2006.

5. The current paper is concerned with further issues that have been identified under the technical review of the Code.

6. Consultees are invited to make submissions and address the questions in the paper.

7. The paper is in two sections. Section One considers three substantive issues, namely:

   (a) the lack of information about the status of defeating conditions during the offer period (paragraphs **14 to 45**);

   (b) the lack of specificity of the offeror's statement of its intentions for the target company (paragraphs **46 to 65**); and

   (c) follow-on offers (paragraphs **66 to 89**).

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[1] Takeovers Act 1993, section 8(1)(a).

[2] *Marlborough Lines Ltd v Takeovers Panel* HC Wellington, 12 October 2010 (CIV-2010-485-001150) Mackenzie J. The High Court found, among other things, that the Panel does not have jurisdiction to hold a meeting under section 32 of the Takeovers Act in respect of disputes concerning the recovery of properly incurred expenses by a target company from an offeror under rule 49 of the Code.

8. Section Two identifies some drafting anomalies and inconsistencies in the Code which require remedying, but would not result in any substantive changes to the Code.

Request for comments on this paper

9. The Panel invites submissions on the preferred options in this paper. The closing date for submissions is **Friday, 26 August 2011**.

10. Submissions should be sent to the Takeovers Panel:

- by email - takeovers.panel@takeovers.govt.nz
- by post - Takeovers Panel
  Level 3, Solnet House
  70 The Terrace
  P.O. Box 1171
  WELLINGTON 6011
- by fax - +64 4 815 8459.

Official Information Act 1982

11. Any submissions received are subject to the Official Information Act 1982. The Panel may make submissions available upon request under that Act. If any submitter wishes any information in a submission to be withheld, the submission should contain an appropriate request (together with a clear identification of the relevant information and the reasons for the request). Any such request will be considered in accordance with the Official Information Act 1982.

Policy Objectives

12. The Panel's policy objective in undertaking this review of the Code is to identify areas where the Code can be improved to ensure that:

    (a) investors in New Zealand Code companies are fully informed in respect of an offer for their voting securities;

    (b) the market for takeovers of Code companies is efficient and competitive; and

    (c) the confidence of investors in the integrity of New Zealand's takeovers market is maintained.

13. The Panel also wishes to improve clarity and certainty about the requirements of the Code through removing inconsistencies in the wording of the Code and other drafting anomalies.

SECTION ONE – SUBSTANTIVE ISSUES

Status of defeating conditions during the offer period

Problem identification

14. An offer made under the Code may be subject to any conditions, except for those that:

 "…depend on the judgement of the offeror or any associate of the offeror, or the fulfilment of which is in the power, or under the control, of the offeror or any associate of the offeror."[3]

15. If the offeror makes its offer subject to conditions, it must specify a date by which the offer is to become unconditional.[4] The specified date is subject to prescribed time limits. It must be no more than 14 days after the end of the offer period (or, in cases where the transaction requires statutory approval (e.g., under the Overseas Investment Act 2005), 30 days after the end of the offer period).[5] If the offer does not become unconditional by the specified date, it will lapse.[6]

16. The offeror is under no obligation in the Code to provide on-going information to offerees or the market on the status or the fulfilment of conditions during the offer period.[7] The offeror's only obligation is to give notice that the offer is unconditional on the date specified in the offer document. This date may be up to 30 days after the close of the offer. This is a significant period of time during which the offerees and the target company may not know whether the offer will succeed.

17. In practice, offerors may issue a public statement in respect of the satisfaction of a condition during the offer period. This could have tactical advantages for the offeror (for instance, an offer with fewer conditions may be more attractive to offerees).

18. In the case of a target company that has voting securities quoted on an NZX market, the company has a general obligation to provide any information that is *"material information that is not generally available to the market"*.[8] It is possible that during the offer period, the target company may disclose information as a result of this obligation that relates to the status of a condition of the offer. Likewise, if the offeror is a public issuer, it too may disclose information under the continuous disclosure requirements regarding the status of its offer conditions.

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[3] Rule 25(1) of the Code.
[4] Rule 25(2) of the Code.
[5] Rule 25(3) of the Code. There are provisions in the Code to deal with changing the specified date for declaring the offer unconditional in the event that the offeror extends the offer period (see rule 25(3) and rule 27(e)).
[6] Rule 25(4) of the Code.
[7] Under rule 49A of the Code, the offeror must notify the Panel and the target company each time the acceptances received increase by 1% or more. To some extent, this disclosure process informs the market of the status of any minimum acceptance condition in the offer.
[8] Securities Markets Act 1988, section 19C.

Australia

19. In general, Australia regulates the use of conditions in a takeover offer differently to New Zealand.

20. If a condition is waived or satisfied during the offer period, the offeror must give a public notice to this effect as soon as practicable.[9]

21. If the offeror makes an offer that is subject to conditions, the offer must specify a date in the second to last week of the offer period at which the offeror will give a public notice regarding the status of the conditions.[10] The notice must state: [11]

    (a) whether the offer is free of conditions;

    (b) whether, so far as the offeror knows, the conditions have been fulfilled at the date of the notice; and

    (c) the offeror's voting control percentage in the target company (as at the date of the notice).

22. The offeror is prevented from waiving conditions in the final seven days of the offer period.[12] There is, however, an exception to this rule in respect of conditions which relate to certain prescribed occurrences (such as specific corporate financing transactions undertaken by the target company (a buyback of shares or the issue of new shares or options), and other major transactions). The offeror has until three working days after the close of the offer period in which to declare the offer free of those conditions.[13]

23. The legislation provides that if the offeror has not declared the offer free from conditions in accordance with the notice procedure, and the conditions have not been fulfilled at the close of the offer period, any acceptances will be void.[14] In effect, this means that the offeror must make an important decision with respect to the conditions of the offer in the final week of the offer period. The offeror: [15]

    > "*must make a decision whether to declare the offer unconditional and risk possible loss from the occurrence of any of the events against which the conditions were designed to provide protection or to retain the conditions and possibly be forced to return all acceptances if a minor breach occurs. The legislation requires this difficult decision to be made at least seven days before the offer closes. The only exception to this rule is that 'prescribed occurrence' conditions can be held and waived three days after the bid closes.*"

24. The intention of the legislation is to provide greater certainty to offerees. If the offeror does not declare the offer to be unconditional (except in relation to the prescribed occurrences) seven days before the close of the offer period, the offer will fail if any

[9] Corporations Act 2001 (Cth), section 630(4).
[10] Corporations Act, section 630(1).
[11] Corporations Act , section 630(3)
[12] Corporations Act, section 650F(1)(b).
[13] Corporations Act, section 650F(1)(a)
[14] Section 650G
[15] R Levy and N Pathak *Takeovers Law & Strategy* (Lawbook Co., Sydney, 2009, 3rd edition), page 204.

of the outstanding conditions are triggered (because the offeror is forbidden from waiving those conditions). This results in less flexibility for the offeror. Conversely, an offeree in Australia, in contrast to New Zealand, is not in the position of having to decide whether to accept a conditional offer (except in relation to the prescribed occurrences) in the final days of the offer period.

25. In addition, Australia provides for the automatic extension of the offer period if, in the last seven days of the offer period, the offeror raises the offer price or receives acceptances that take its voting control in the target company to more than 50%. The offer period is automatically extended for a further 14 days if either of theses events occur.[16] The Australian legislation underscores the principle that these events are significant during the course of the takeover. The extension gives offerees more time to consider whether to accept or reject the offer in light of these changes in circumstances

New Zealand

26. In New Zealand, the offeror is only required to advise the offerees (and the wider market) of the unconditionality of the offer on the date specified in the offer document. This can leave a considerable period of time where the offerees are uninformed about the status of the conditions of the offer.[17] By contrast, in Australia an offeree will know by the time the offer closes whether the offer is unconditional (except in relation to the “prescribed occurrences” conditions).

27. The Code does place restrictions on the variations that an offeror is able to make to an offer. The only permissible variations are:

    (a) an increase in the offer consideration (or the addition of a cash component or cash alternative to the consideration); and

    (b) an extension of the offer period (and, if the offer period is extended, to vary the date on which the offer must be declared unconditional).[18]

28. If any of these variations occur, the offer must remain open for at least an additional two weeks after the variation.[19] This gives the offerees more time to consider the offer in light of the variation.

29. However, an offeree in New Zealand is not given more time to consider the offer if, in the final stages of the offer period, the offeror has gained enough acceptances to satisfy a minimum acceptance condition, or where a minimum acceptance condition is waived. Indeed, in the Panel’s experience, such an event can occur at the “last minute” of the offer period. The Panel considers that such an event is a significant change in circumstances. Accordingly, the offerees, and the board of the target company to whom the offerees look for advice in respect of the offer, may not have

[16] Corporations Act, section 624(2).
[17] Although this lack of information is sometimes addressed voluntarily by the offeror issuing public statements about the status of the conditions, or under continuous disclosure obligations on listed companies, in all other cases uncertainty prevails during the offer period.
[18] Rule 27 of the Code.
[19] Rule 29 of the Code.

much time to consider the offer in light of the change in circumstances. The Panel considers that this is a deficiency in the Code, and that the board and offerees should be given additional time to re-evaluate their positions.

30. It is not possible to quantify the magnitude of any problem associated with a lack of information in New Zealand about the status of the offer conditions. It is likely that the costs are not great, but a lack of information creates uncertainty, and uncertainty has a negative impact on the market. Similarly, it is not possible to quantify the harm caused by the lack of an automatic extension to the offer period when a minimum acceptance condition is satisfied.

Options

31. The following options have been identified for addressing the problem:

Option one: maintain the status quo

32. One option is to maintain the status quo.

33. The disadvantage of the status quo is that the offerees lack information in respect of the status of the conditions of the offer until after the close of the offer period. Although not directly affected, the wider market is also uninformed. Furthermore, under the status quo, the offerees may not always have enough time to consider a change in circumstances such as the satisfaction of a minimum acceptance condition. This can put the offerees at a disadvantage if they do not have enough time to consider its effect before making a decision to accept or reject the offer.

34. The continuous disclosure regime for public issuers does not completely address the information problem. Firstly, it depends on one or both of the offeror and the target company being public issuers. A company does not have to be a public issuer to be a Code company.[20] Similarly, a bidder may not be a public issuer. Secondly, the relevant information must be of such a nature that its possession by the offeror and/or target company (being a public issuer) would trigger the disclosure obligation. This may not always be the case.

35. While the offeror could, during the offer period, voluntarily provide information that informs the offerees of the status of the defeating conditions, it has no obligation to do so, which leaves the problem unaddressed.

36. The market operates more effectively when the offerees, the target company, and the wider market are fully informed about the takeover offer during the offer period. Market efficiency is further enhanced if the offerees have sufficient time to consider

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[20] Under rule 3(1) of the Code, “Code company” means a company that:
(a) is a party to a listing agreement with a registered exchange and has securities that confer voting rights quoted on the registered exchange’s market; or
(b) was within paragraph (a) at any time during the period 12 months before a date or the occurrence of an event referred to in the Code; or
(c) has 50 or more shareholders.

the relevant information in relation to a takeover. Accordingly, for the above reasons, the Panel does not favour maintaining the status quo.

Option two (the preferred option): require the offeror to give notice of the status of defeating conditions prior to the close of the offer period, together with automatic extension of the offer period if the offeror satisfies or waives any minimum acceptance condition in the final week

37. The Panel's preferred option is to recommend to the Minister that the Code be amended to include new provisions, to the following effect:

24C Automatic extension if the offeror satisfies or waives minimum acceptance condition in final week

(1) This rule applies if:

(a) The offer is subject to 1 or more minimum acceptance conditions; and

(b) any such condition is satisfied or waived in the period that is 7 days before the end of the offer period.

(2) If subclause (1) applies, the offer period is extended for 14 days from the day on which a condition referred to in subclause (1) is satisfied or waived.

(3) If the offer period is extended under subclause (2), the offeror must immediately send a written notice of the extension to:

(a) every offeree who has not already accepted the offer; and

(b) the target company; and

(c) the Panel; and

(d) the registered exchange (if any voting securities of the target company are quoted on the registered exchange's securities market).

(4) In this rule, a ***minimum acceptance condition*** *means a term of the offer which provides that the offer is conditional on the offeror receiving acceptances in respect of voting securities that, when taken together with voting securities already held or controlled by the offeror, confers more than a percentage level or number of voting securities specified by the offeror and which complies with rule 23.*[21]

[21] If the Panel's preferred option is adopted, the following consequential amendments to the Code would be required:

- Rule 24A(1) would have to provide that rule 24C overrides the prohibition in rule 24A(1) against extending the offeror period beyond 90 days;
- Rule 24A(3) would have to include rule 24C extensions in the offer period; and
- Rule 33(1) would have to include an additional subparagraph "*(d) in the case of a partial offer, any automatically extended closing date under rule 24C.*"

> ***Examples:***
>
> *An offeror provides that its offer is conditional upon receipt of acceptances that will confer holding or control of more than 90% of voting rights. That condition may be waived. The offer is also conditional on the offeror receiving acceptances that will confer holding or control of more than 50% of voting rights. On the third day before the offer is scheduled to close, the offeror has received acceptances for 60% of voting rights. The offer is automatically extended for 14 days from that date by rule 24C, regardless of whether or not the offeror has waived the 90% condition.*
>
> *A partial offer is conditional upon receipt of acceptances that will confer holding or control of more than 50.1% of voting rights (although the specified percentage of securities sought, if achieved, would result in the offeror acquiring 55% of voting rights). On the fifth day before the offer is scheduled to close, the offeror has received acceptances that would result in it holding or controlling 50.1% of voting rights. The offer is automatically extended for 14 days from that date by rule 24C.*

49B Notice requirements in respect of conditions

(1) The offeror must give notice to the target company, the Panel, and, if the target company is a listed company, the registered exchange, at least 7 days, but no more than 14 days, before the end of the offer period, of the following:

(a) that the offer is, and remains, subject to conditions as specified in the offer document;

(b) whether, to the best of the offeror's knowledge and belief, any (and, if so, which) conditions have been fulfilled or satisfied at the date of the notice;

(c) whether the offeror has the right to waive any of the conditions to which the offer remains subject as at the date of the notice and, if so, which conditions; and

(d) the percentage of voting rights in the target company in respect of which the offeror has received acceptances as at the date of the notice together with the percentage of voting rights already held or controlled by the offeror (if any).

(2) Subclause (1) does not apply if, at the date that the notice would be given, the offer is not subject to any conditions.

(3) If the offer period is extended after a notice has been given under subclause (1), a new notice must be given in accordance with subclause (1).

38. The preferred option introduces two new rules:

(a) An automatic extension of the offer period if, in the final week of the offer period, the offeror receives sufficient acceptances to satisfy or waive one or more minimum acceptance conditions; and

(b) A requirement that the offeror gives an update in the second to last week of the offer period of the status of the conditions of the offer.

39. The offeror would still be required to give notice in accordance with rule 25(5) of the Code on the date that the offer becomes unconditional, or, if it lapses, to give notice to that effect in accordance with rule 26 of the Code.

40. Achieving, or waiving, a minimum acceptance threshold is a significant event during the course of a takeover offer. In the Panel's experience, it may alter the views of the directors of the target company and of the offerees as to the merits of accepting the offer. Accordingly, it is appropriate that a suitable period of time is made available for interested parties to consider the effect of this change when deciding whether to accept or reject the offer. The additional time period, in the Panel's view, will be particularly valuable to retail shareholders because they may need more time to consider the information than, say, a large financial institution.

41. The new notice requirements in the preferred option directly addresses the problem identified above; that the offerees, the target company and the market may not know the extent to which the offer is still subject to conditions, until after the offer has closed. They do not always receive information during the offer period in respect of the status of the conditions of the offer. Under the preferred option, the market will receive an update a short time prior to the close of the offer. The offeror must also state whether any of the conditions to the offer that remain unfulfilled as at the date of the notice are waivable. This ensures that complete information is available about the progress of the offer.

42. It would be a significant change in the policy of the Code (and is not being proposed by the Panel) to require the offeror to declare the offer unconditional before the close of the offer period (or risk the offer failing due to some immaterial triggering event, as is the case in Australia). Although a conditional offer may run for a substantial period of time (up to 90 days), some matters which are frequently the subject of conditions may not be completed within that time period (for example, regulatory approvals). In addition, the Panel accepts that offerors should be entitled to rely on 'material adverse change' conditions. The preferred option does, however, require the offeror to update the status of the conditions of the offer at the date that it gives the notice. This enables the best available information at the time to be given to the offerees. This will be particularly important information if a second bidder enters the contest. Offerees may then be reluctant to accept a conditional offer if the other offer is unconditional. In other words, more information assists in decision-making.

43. No change is being proposed to rule 25(5) of the Code (which relates to the specified date by which the offeror must declare the offer unconditional). The Panel notes that a very different approach has been taken in Australia whereby the offer fails automatically if it is not declared unconditional one to two weeks before the offer closes or if any outstanding conditions are not fulfilled (or a defeating condition is triggered) by the end of the offer period. The Panel would be interested in the views of the market on whether it would be appropriate for the regime in New Zealand to be more consistent with that in Australia.

44. The preferred option would result in some additional costs being incurred by the offeror in preparing and issuing the notices. However, the Code includes numerous requirements for the offeror to give notice in respect of various matters. Accordingly, offerors already have in place the processes required for distribution of information to the market and to shareholders and this established practice means that the real additional costs are fairly marginal, i.e., legal advice on the rule, the time of company executives. In the context of takeover transactions (which typically involve many millions of dollars), the additional cost is minimal.

45. The proposed notices would ensure that the market and all interested parties are kept up to date on the status of the conditions to the offer and have adequate time to make their decisions. Therefore, it meets the Panel's policy objectives of ensuring that investors in New Zealand Code companies are fully informed in respect of an offer for their voting securities.

QUESTIONS

1. Do you agree that there is a problem with offerors being under no obligation to publicly notify the status of the conditions of the offer during the offer period?

2. Do you:

   (a) support the Panel's preferred option of introducing an automatic extension of the offer period if the offeror achieves a minimum acceptance level in the final week of the offer?
   (b) think that this could cause problems to offerors?
   (c) think the proposed extension of 14 additional days is appropriate?

3. Do you think that the automatic extension should apply if an offer includes a non-waivable 90% minimum acceptance condition?

4. Do you support the Panel's preferred option for the giving of a notice in respect of the status of conditions? If so, why? If not, why not?

5. What are your views on moving closer to the Australian approach regarding the waiving of conditions in the final week of the offer?

6. Do you have any other comments or suggestions which you would like to contribute?

<u>Statements by the offeror of its intentions for the Code company</u>

<u>Problem identification</u>

46. The draft offer document that accompanies a takeover notice, and the formal offer document sent by the offeror to shareholders, must contain the information prescribed by Schedule 1 of the Code.

47. Clause 14(1) of Schedule 1 of the Code requires the offeror to include in the offer document a statement of *"the general nature of any material changes likely to be made by the offeror in respect of the business activities of the target company and its subsidiaries*." The offeror does not have to provide this statement if the offer is subject to a non-waivable condition that the offeror receives acceptances in respect of 90% or more of the voting rights in the Code company.[22]

48. Arguably, an offeror is not required by clause 14(1) to give comprehensive information to the offerees about its intentions for the target company. If so, the offerees may lack access to important information when considering whether to accept or reject the offer. This is particularly acute in partial offers which necessarily result in some or all of the offerees remaining as shareholders of the target company. They have a remaining direct interest in knowing the extent to which the offeror will add value to the company (and, therefore, to their investment).[23]

49. Overseas jurisdictions have adopted different approaches to requiring a statement by the offeror in respect of its intentions for the target company.

50. In the United Kingdom, the offeror must state in its offer document:

    (a) its intentions regarding the future business of the target company;

    (b) its strategic plans for the target company, and their likely repercussions on employment and the locations of the target company's places of business;

    (c) its intentions regarding the future redeployment of the fixed assets of the target company;

    (d) the long term commercial justification for the proposed offer; and

[22] Clause 14(2), Schedule 1 of the Code. This subclause is discussed later in this discussion paper.
[23] Similar considerations apply in respect of full offers that contain a waivable condition that the offeror receives acceptances in respect of 90% or more of the voting rights in the target company. If the condition is satisfied, the offeror would be entitled to compulsorily acquire any remaining voting securities under Part 7 of the Code. However, if the condition was not satisfied and the offeror elected to waive it, the offeror would take up those voting securities in respect of which it had received acceptances and those offerees who had not accepted the offer would remain shareholders in the target company.

(e) its intentions with regard to the continued employment of the employees and management of the target company and of its subsidiaries, including any material change to the conditions of employment.[24]

51. In addition, the UK requires the board of the target company to give its views on:

(a) the effects of implementation of the offer on all the target company's interests, including, specifically, employment; and

(b) the offeror's strategic plans for the target company and their likely repercussions on employment and the locations of the target company's places of business.[25]

52. The UK's Takeover Panel has recently undertaken public consultation on various aspects of the City Code on Takeovers and Mergers following the 2010 hostile takeover of Cadbury plc by Kraft Foods Inc.[26] The UK Panel issued its response to the submissions received, in October 2010.

53. As a result of this process, the UK Panel is proposing changes to the City Code to require further disclosures to be provided to offerees. This is on the basis that the ability of the board of the target company and other interested parties (such as representatives of employees) to comply with their respective obligations, and to provide meaningful advice to offerees and employees, depends on the accuracy and adequacy of the information published by the offeror in accordance with its own obligations. The UK Panel is proposing a further additional disclosure to the effect that if the offeror has no plans in terms of paragraph 50 above, it must make a negative statement to that effect.[27]

54. In Australia, the offeror must make a statement of the following in its offer document:

(a) its intentions regarding the business of the target company;

(b) any major changes to be made to the business of the target company, including redeployment of the fixed assets of the target company; and

(c) the future employment of the present employees of the target company.[28]

55. An offeror making an offer for a New Zealand Code company is not required to make such extensive statements in respect of its intentions for the target company as those required in the UK and Australia.

56. The Panel considers that the level of disclosure by an offeror of its intentions for the target company could be improved. The Panel is interested in what level of disclosure the market considers would be appropriate for New Zealand.

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[24] The City Code on Takeovers and Mergers (United Kingdom), rule 24.1. The UK rule came into effect in its current form in 2006 and implements aspects of the European Directive on Takeover Bids.
[25] Ibid, rule 25.1.
[26] PCP2010/2 (1 June 2010), available from http://www.thetakeoverpanel.org.uk
[27] Statement 2010/22 (21 October 2010), available from http://www.thetakeoverpanel.org.uk
[28] Corporations Act 2001, section 636(1)(c).

Options

57. The following options have been identified for addressing the problem.

Option one: maintain the status quo

58. If the status quo is maintained, it would have two disadvantages:

(a) Shareholders remaining in the company may have little information regarding how the new owner will affect the company's profitability. The problem may be acute in the case of a partial offer because the shareholders are, by definition, not able to sell all of their shares into the offer. They will remain shareholders in the company after the change in control.

(b) The obligations of offerors under the New Zealand Code are out-of-line with the comparable jurisdictions of the UK and Australia. Both of those jurisdictions, which are major centres of mergers and acquisitions activity, impose greater disclosure obligations on offerors than those under the New Zealand Code.

59. Accordingly, the status quo is not the ideal position because it does not meet the Panel's policy objective of ensuring that investors in New Zealand Code companies are fully informed in respect of an offer for their voting securities.

Option two (preferred option): require more particulars to be stated by the offeror of its future intentions for the target company

60. The Panel's preferred option is to recommend to the Minister that the Code be amended to require the offeror to make a statement to the following effect in the offer document:

14(1) A statement of the following:

(a) the offeror's strategic expectations regarding the future business activities of the target company or its subsidiaries;

(b) any material changes likely to be made by the offeror in respect of the business activities of the target company or its subsidiaries;

(c) the offeror's expectations regarding the future ownership or use of the assets of the target company or its subsidiaries;

(d) any material changes likely to be made to the capital structure of the target company, including as to the target company's dividend policy, and the raising of capital or the taking on of debt;

(e) any other information about the likelihood of changes to the target company or its subsidiaries that could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the offer.

(1A) If the offeror has no expectations or intentions in respect of any of the matters in subclause (1), the offer document must include a statement to that effect.

61. The preferred option would have advantages for the following persons interested in the takeover process:

(a) **Offerees**: The additional information should assist offerees to understand the consequences of the takeover on their investment (if they will retain shares in the target company).

(b) **The rule 21 independent adviser**: an independent adviser approved by the Panel must give a report, to be included in the target company statement, on the merits of the takeover offer.[29] The offeror's intentions for the target company will be factors considered by the independent adviser in its assessment of the merits of the offer.

(c) **The directors of the target company**: the directors of the target company must provide, in the target company statement, a recommendation to the offerees to accept or reject the offer, together with the reasons for the recommendation.[30] If the directors are better informed about the offeror's intentions for the target company, it will assist them in providing a better recommendation to the offerees.

(d) **The Panel**: Any statements by parties to a takeover of their intentions are made to influence other parties, and they are considered by the Panel to be 'last and final statements'.[31] The Panel considers that any action by a party which is inconsistent with a last and final statement that that party has made risks breaching rule 64 of the Code. Rule 64 prohibits any person from engaging in conduct that is misleading or deceptive. The Panel may consider a clause 14(1) "intentions" statement by the offeror to be a last and final statement.

62. The disadvantage of the preferred option is that it may oblige prospective offerors to disclose commercial information to the public (the offer document being a public document). Prospective offerors may be discouraged from making an offer if such information will be made public.

63. However, the extent to which this may be a real disadvantage is questionable. The UK (whose takeovers regulations fit within a common European Union framework) and Australia are major centres of mergers and acquisitions activity. Those jurisdictions require extensive disclosure of the "intentions" information by offerors.

64. There is a risk that an offeror will make a statement that lacks substance. The Panel understands that this may be a problem in practice with the UK and Australian regimes. This is, however, also a risk under the status quo in New Zealand.

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[29] Clause 19, Schedule 2 of the Code.
[30] Clause 15(1), Schedule 2 of the Code.
[31] The Panel's policy on last and final statements is discussed in full in *Code Word No. 22* (December 2007). Available online at http://www.takeovers.govt.nz.

65. The UK and Australia both require the offeror to make a statement, effectively, in respect of its intentions regarding the future employment of the employees of the target company. The Panel is not proposing that such a statement be required of an offeror under the New Zealand Code.

QUESTIONS

1. Do you agree that there is a problem with the level of disclosure currently required of the offeror by clause 14(1) of Schedule 1 of the Code?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you think the preferred option should include additional required disclosures, such as–

   (a) The intentions of the offeror regarding continuation of employment of the general staff of the target company?

   (b) The long term commercial justification for the offer?

   (c) Anything else?

4. Do you have any other comments or suggestions which you would like to contribute?

Follow-on offers

Problem identification

66. A follow-on offer is an offer made by an offeror subsequently to an offer that had been made by the same offeror for the target company at an earlier time. The offeror will not have acquired enough voting rights through the first offer to invoke the Code's compulsory acquisition provisions (90% or more) and, therefore, undertakes a second offer in an attempt to reach the 90% threshold and so gain 100% control of the target company. The scenario in mind relates only to takeover offers where the Code's 50% minimum acceptance requirement has been met (for example, the offeror achieves 80%) under the first offer, and the offeror declares the offer unconditional and takes up the shares that were accepted into the offer.

67. The offeror does not have to make a public statement as to the likelihood of a follow-on offer being made for the target company. However, if the offeror does make any public statement in this respect, it has consequences under the Code (see below).

68. The Code allows for the making of follow-on offers. There are, however, some qualifications to this position:

    (a) The follow-on offer must be distinct from the previous offer. Rule 20 of the Code provides that an offer must be made to all offerees on the same terms and for the same consideration. The Panel has found that the Code was breached when an offeror made a two-stage offer for shares in the target company; the first stage was a partial offer at a certain price, and the second stage was an offer for the remaining shares in the target company at a lower price. The occurrence of the second stage was conditional on completion of the first stage. The Panel found that although the offer was made on the same terms to all offerees, it was an offer for different prices and, accordingly, did not comply with rule 20 of the Code;[32]

    (b) Under rule 64 of the Code, which prohibits persons involved in takeover transactions from engaging in misleading or deceptive conduct, an offeror cannot undertake a follow-on offer if it has previously made an unqualified public statement that it had no intention of doing so. Such inconsistent behaviour would indicate that the offeror had misled the market when it issued its public statement.[33]

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[32] Takeovers Panel *Determination – Lion Nathan Enterprises Limited* (16 July 2001), available online at http://www.takeovers.govt.nz.

[33] For example, in July 2010, Olam International Limited ("Olam") made a full offer for all the shares in NZ Farming Systems Uruguay Limited ("NZFSU") that it did not already hold or control. The offer document contained a statement that *"if [the] offer is declared unconditional, then for a period commencing on the date the offer is declared unconditional and ending on 31 March 2011, neither Olam nor any related company of Olam will make any further takeover offer under the Takeovers Code to acquire shares [in NZFSU] at a price per share that is higher than the consideration per share to be paid under this offer"*. When Olam made its follow-on offer for NZFSU, it waited until after 31 March 2011, so that there was no inconsistency with its July 2010 statement.

69. In Australia, the offer consideration must be equal to or exceed the maximum consideration paid by the offeror, or its associates, for any shares in the target company for the period four months before the making of its current offer.[34] The purpose of this minimum pricing rule is to ensure that all shareholders in the target company are treated equally by the offeror.[35]

70. The UK also has a minimum pricing rule with implications for follow-on offers being made. If a person holds more than 50% of the voting rights in a company, neither that person or another person acting in concert can, within six months of a previous offer, make a second offer to the shareholders of the company (or acquire any interest in the company) *on terms more favourable* than those of the previous offer.[36]

71. The New Zealand Code does not contain any pricing rule, except to the extent that rule 20 of the Code requires that the same consideration in an offer be offered to all offerees under the offer.

72. An offeror may issue a public statement to the effect that it will, or will not, make a follow-on offer. The Panel would likely consider such a statement to be a ‘last and final statement’ (see paragraph 68(b), above). If the offeror later engaged in conduct that was inconsistent with the statement, that conduct may result in the offeror breaching the prohibition on misleading or deceptive conduct in rule 64 of the Code.

73. Follow-on offers are controversial because a different price may be offered by the offeror for shares in the target company than was offered in the earlier offer. The remaining shareholders may consider the follow-on offer to be unfair if the earlier offer had had a higher price. Conversely, those former shareholders in the target company who had accepted an earlier offer may consider themselves disadvantaged if the offeror makes a subsequent offer at a higher price.

74. To date, it has been rare for a follow-on offer to be made in close proximity to an earlier offer. However, one example of a prompt follow-on offer was the takeover of Carter Holt Harvey Limited by Rank Group Investments Limited in February 2006. The first offer was for $2.50 cash per share, and the second offer made soon after was for $2.75 cash per share. Another example was MediaWorks NZ Limited (“MediaWorks”): in July 2007, HT Media Limited made an offer of $2.68 cash per share for the remaining shares in MediaWorks that it had not acquired under its earlier offer of $2.33 per share. In some cases, a new offer is made several years after the first one.[37]

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[34] Corporations Act 2001, section 621(3).

[35] Australian Securities and Investments Commission, *Regulatory Guide 163: Takeovers – minimum bid price principle: s621* (19 December 2000). Available online at http://www.asic.gov.au.

[36] City Code, rule 35.3.

[37] For example, the offer by Spotless Services (NZ) Limited for Taylors Group Limited in late 2009. The offeror had acquired a controlling position in the target company by way of a takeover a number of years before.

<u>Options</u>

75. The following options have been identified for addressing the problem.

Option one: require the offeror to make a statement in respect of the possibility of a follow-on offer

76. Under this option, the Panel would recommend to the Minister that the Code be amended to require the offeror to make a statement as to whether it has any intention of making a follow-on offer. The amendment would be along the following lines:

    The offer document must include:

    A statement of the offeror's intentions regarding making a subsequent offer for shares in the target company if –

    (a) the offeror takes up securities under the current offer; and

    (b) the current offer is not conditional on the offeror receiving acceptances that will result in the offeror being required to give an acquisition notice under rule 54 [i.e., it does not have a 90% minimum acceptances condition].

77. Prima facie, a statement by the offeror as to whether or not it will make a follow-on offer would give certainty to the offerees. This may address the concerns of potential unfairness. The offerees can assess the likelihood of a follow-on offer as one of the considerations in deciding whether to accept or reject the offer.

78. However, in practice it is difficult to see the statement being of real utility. The offeror would likely qualify the statement to such an extent that it would not be bound one way or the other, hence leaving it unclear as to whether or not it will in fact make a follow-on offer. Moreover, if the offeror was required to make a specific statement, it might be discouraged from making any offer at all. The offeror will be effectively bound to the statement as a result of rule 64 of the Code. It may not be in a prospective offeror's best commercial interests to make a public commitment to making, or not making, a follow-on offer.

79. Accordingly, for these reasons the Panel is not in favour of this option. It would not contribute to making the market for takeovers of Code companies efficient and competitive. Also it would probably not make investors any more fully informed.

Option two: require a minimum consideration to be paid

80. Under this option, the Panel would recommend to the Minister that a minimum pricing rule be introduced into the Code on the following terms:

    20A Minimum consideration
    The consideration must be equal to or greater than the consideration paid by the offeror, or by any associate of the offeror, for any voting securities in the target

company during the period of four months prior to the offeror giving a notice under rule 41 of the Code.

81. This would be a similar provision to the requirements in Australia. The new rule would affect first offers as well as follow-on offers (as is the case with the pricing rule in Australia). It is common for a prospective offeror to acquire securities in the target company, in advance of making a takeover offer, below the 20% threshold at which the Code applies.

82. A minimum pricing rule would go some way towards addressing any perceived unfairness to shareholders in the target company if the offeror makes a follow-on offer. The remaining shareholders in the target company can be certain that if any follow-on offer is made within four months of the previous offer, those shareholders/offerees will be offered at least the same consideration as was offered for the previous offer.

83. However, if the offeror wished to offer different consideration, it would only need to wait four months before doing so. The remaining shareholders may still perceive that they are being treated unfairly (four months is not a very long time).

84. Moreover, the introduction of a minimum pricing rule into the Code would be a significant policy change. It might be better left for consideration under a general, first principles, review of the New Zealand Code. Accordingly, it would not be appropriate for the Panel to be recommending such a change to the Code at this stage. In any event, the problem may have largely been resolved with the introduction, in 2008, of rule 64 of the Code and the Panel's published position regarding how it treats 'last and final statements'.[38]

85. For the above reasons, the Panel is not in favour of recommending that a minimum pricing rule be included in the Code.

Option three (preferred option): maintain the status quo

86. Under this option, the status quo would be maintained.

87. Follow-on offers are relatively uncommon in New Zealand. Since the introduction of rule 64 of the Code, offerees have been able to rely upon any statements made by the offeror in respect of its intentions to make (or not make) a follow-on offer. This has given an additional degree of certainty to shareholders (although the offeror is not obliged to make any such statement). The Panel has seen examples of this working in practice.[39]

88. Independent advisers often opine on the possibility of a follow-on offer being made, in their reports under rule 21 of the Code on the merits of the offer. The possibility of the offeror making a follow-on offer is one factor among many that the offerees must consider in deciding whether to accept the offer. Accordingly, the offerees should be

[38] *Code Word No. 22* (December 2007). Available online at http://www.takeovers.govt.nz.
[39] See footnote 33.

alert to the consequences of a follow-on offer being made, and consider this when deciding whether to accept the offer.

89. Although the New Zealand Code is different to the regimes in the UK and Australia, the extent to which any problem exists in New Zealand is not clear. Accordingly, the Panel's preferred option is to maintain the status quo, unless it becomes clear that the problem is real.

QUESTIONS

1. Do you agree that follow-on offers are not a current problem in New Zealand? If you perceive follow-on offers to be a real problem, why is this and what is the extent of the problem in your view?

2. Do you have any other comments or suggestions which you would like to contribute?

SECTION TWO – DRAFTING ANOMALIES AND INCONSISTENCIES

"Sending" and "delivering" consideration

Problem Identification

90. There are a number of references in the Code to the offeror "sending" or "delivering" the consideration for the offer:

- Rule 33(1): the offer must specify a date by which the consideration must be *sent* to the offerees;
- Rule 34: an offeree has the right to withdraw its acceptance if the offeror does not *send* the consideration within a prescribed time limit;
- Rule 60: the dominant owner, who is making a compulsory acquisition of shares under the Code, must *send* to the outstanding security holders the acquisition consideration within seven days of receiving the signed instrument of transfer;
- Rule 61: in cases where an outstanding security holder does not return the instrument of transfer to the dominant owner, the dominant owner must *deliver* to the Code company the consideration specified in the acquisition notice (or the alternative consideration, if that option is available).

91. The Code does not prescribe the kinds of consideration that may be provided under the offer. Normally, the consideration is cash or securities ("scrip"), or a combination of both. However, the Code is drafted broadly enough to allow for other types of consideration to be used.

92. If the consideration is, or includes, scrip, it may be impossible for the offeror to literally "send" or "deliver" it, as the case may be. Transactions in securities normally occur though an electronic transfer system. NZX Limited operates a clearing and settlement system and the FASTER transfer system, which involve the allocation to security holders of an identifying number and the transfer of securities through share brokers.[40] The Reserve Bank of New Zealand, through its NZClear system, also provides an electronic system for the transfer of securities amongst financial institutions.[41]

93. In any event, allotment occurs when the relevant shares are entered on the company's share register against the name or names of the allottee(s) or transferee(s). The entry on the company's share register is prima facie evidence that legal title to the shares vests in the named person.[42] Even before the advent of electronic trading systems,

[40] Securities Transfer (Approval of FASTER System) Order 2001.
[41] Securities Transfer (Approval of Austraclear New Zealand Electronic Registries Interface System) Order 2010.
[42] Companies Act 1993, section 89.

shares were not themselves sent or delivered to allottees or transferees. Only evidence of the allotment or transfer is sent or delivered (in the case of electronic transfers, by way of share statements, and in the case of non-electronic trading, by way of share certificates).

94. Accordingly, the best that an offeror can do to “send” or “deliver” scrip consideration, as the Code requires, is to provide evidence that the appropriate electronic (or non-electronic) transactions have occurred. The security holder does not receive a “share” as such. The concern is that the words used in the Code, “send” or “deliver” may not accurately reflect what occurs when shares are transferred or allotted and may lead to the offeror being uncertain about what its obligations under the Code in practice require it to do.

95. Rule 61(2) appears, in the cases of scrip consideration, to require securities to be allotted to the Code company (although, in practice, they may be allotted in the names of outstanding security holders). Accordingly, the Code company may become a shareholder in its parent company (i.e., the dominant owner). The securities are then held on trust for the relevant outstanding security holders.[43] The fact that securities are sometimes issued in the name of the outstanding security holder and sometimes in the name of the target company, indicates that there is real confusion regarding the dominant owners’ obligations under rule 61.

96. The magnitude of this problem is small, in that the majority of offers made under the Code are for cash consideration only. Possibly 10% of offers would be for, or would include, scrip consideration. In relation to those offers, bidders appear to manage their obligations comfortably by ensuring that the scrip consideration is paid (even if it is not exactly “sent” or “delivered” to offerees and even if it is allotted to either of a target company or outstanding security holders).

Options

97. The following options have been identified for addressing the problem.

Option one: maintain the status quo

98. Under this option, the status quo would be maintained.

99. It is arguable that the words “send” and “deliver” can be interpreted purposively to mean “provide”. The meaning of an enactment (such as the Code) must be ascertained from its text and in light of its purpose.[44] The purpose of all of rules 33(1), 34, 60, and 61 of the Code is in some way related to the offerees receiving the consideration due to them. The offeror can send or deliver to the offerees a form of confirmation that scrip consideration has been allotted to the offeree (or to the target company). It would be physically impossible to send or deliver an intangible thing like a “share” to a person (whereas it would be possible if the consideration was cash or a commodity).

[43] Section 82(6) of the Companies Act 1993 permits this.
[44] Interpretation Act 1999, section 5(1).

100. The Panel could issue a guidance note explaining the purposive interpretation of these definitions. This would address any potential uncertainty amongst market participants in respect to the offeror's obligations when the offer consideration is, or includes, scrip.

101. However, the downside of maintaining the status quo would be ongoing ambiguity in the drafting of the Code. To rely on a purposive interpretation of the rules and a guidance note demonstrates that the rules themselves are not certain. One of the Panel's policy objectives in carrying out this review of the Code is to remove inconsistencies in the wording of the Code and other drafting anomalies. Accordingly, maintaining the status quo does not meet this objective.

Option two (preferred option): amend the Code

102. The Panel's preferred option is to recommend to the Minister that the following changes be made to the Code (changes to the existing provisions are shown in underlining):

33 Offer to specify date for payment of consideration

(1) The offer must specify a date by which the consideration for the offer must be sent, in the case of cash or other deliverable consideration, or, in the case of non-deliverable consideration, be provided to the persons whose securities are taken up under the offer.

34 Withdrawal of acceptance for non-payment of consideration

(1) If the consideration is not provided within the period specified in the offer to any person whose securities are taken up under the offer, the person may withdraw acceptance of the offer-
(a) by notice in writing to the offeror; but only
(b) after the expiration of 7 days' written notice to the offeror of the person's intention to do so.

60 Payment of consideration to outstanding security holder

(1) If an outstanding security holder returns to the dominant owner the documents referred to in rule 59, the dominant owner must, within 7 days after the dominant owner receives those documents, provide to the outstanding security holder –
(a) the consideration specified in the acquisition notice; or
(b) if rule 56A applies, the consideration that is payable under that rule.

61 Delivery of consideration to Code company

(1) If an outstanding security holder does not return to the dominant owner the documents referred to in rule 59, then, in the case of a compulsory sale, the dominant owner must, within 7 days after the expiration of the 21-day period referred to in rule 59 –
(a) provide to the Code company –

(i) the consideration specified in the acquisition notice; or

(ii) if rule 56A applies, the consideration that is payable under that rule; or

(aa) <u>if the consideration is, or includes, securities:</u>

(i) <u>allot the securities to the outstanding security holder in accordance with paragraph (a)(i) or (ii) (whichever applies); and</u>

(ii) <u>enter, or procure the entry of, the outstanding security holder's name on the relevant share register as the holder of the securities and the issue of a statement to that person at his, her, or its last known address confirming the registration of that person as the holder of the securities; and</u>

(iii) <u>deliver to the Code company a copy of the statement referred to in sub-paragraph (ii).</u>

103. The proposed amendments would clarify the offeror's obligations under the Code. It meets the Panel's objective to remove inconsistencies in the wording of the Code and other drafting anomalies. Accordingly, the proposed amendment is the Panel's preferred option.

QUESTIONS

1. Do you agree that there is a problem with the Code's references to "sending" and "delivering" consideration?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you think that the proposed new rule 61(1)(aa) is appropriate? If so, why? If not, why not?

4. Do you have any other comments or suggestions which you would like to contribute?

Rule 3(1) – Definitions of "offeror" and "offeree"

Problem identification

104. The interpretation part of the Code, rule 3(1), defines an *offeror* and an *offeree* as follows:

Offeree *means a person to whom an offer is made*

Offeror *means a person who makes an offer*

105. The same rule defines a *target company* as follows:

Target company *means a Code company –*
(a) whose voting securities are the subject of an offer; or
(b) that has received a takeover notice

106. Under the Code, before an offeror makes a takeover offer, it must first issue a notice of intention to make an offer (the "takeover notice") to the prospective target company. The takeover notice contains the terms and conditions of the offer in draft together with disclosure of other important information required by Schedule 1 of the Code. This notice period lasts for at least 14 days, and potentially up to 30 days, before the offeror makes its formal offer.

107. The definition of *target company* makes a reference to the takeover notice, whereas the definitions of *offeror* and *offeree* do not.

108. During the takeover notice period, it is more accurate to describe the offeror and the offerees only as "prospective" because no formal offer has yet been made. The Code, however, refers to certain things that the "offeror" must do during the takeover notice period (such as its obligation to give notice of the record date of the offer).[45] Most of the time, these references are merely a matter of inconsistent drafting and have no practical consequence. However, there is one instance of slightly greater significance.

109. Rule 47(4) of the Code imposes a general obligation on the "offeror" and the "target company", or their respective agents (e.g., legal advisers, employees, etc.), to provide to the Panel copies of all offer-related documentation that is sent to "offerees".

110. Rule 47(4) provides:

An offeror or target company or person acting on behalf of any of them who, in relation to an offer, publishes or sends to any offeree any statement or information that is not required to be published or sent by the rules of this Code must, at the same time that the statement or information is published or sent, also send a copy of it to the Panel in hard copy and (if possible) in electronic form.

[45] Rule 43A(1) of the Code.

111. Rule 47(4) applies to any statement or information that is published or sent by an *offeror* or *target company* to an *offeree*. Read literally, rule 47(4) as currently worded means that, during the takeover notice period, if the "offeror" published information in relation to the offer (e.g., a press release), the "offeror" would not be required to provide a copy of that information to the Panel. This is because during the takeover notice period, the offeror and offeree are only "prospective" (i.e., no offer has been made) and, accordingly, would not literally fall within the definitions of *offeror* and *offeree* in rule 3(1) of the Code.

112. The Panel requires copies of all communications and public statements so that it is kept fully informed of the takeover and is in a position to exercise its enforcement powers, if appropriate (for example, under rule 64 of the Code, which prohibits persons from engaging in misleading or deceptive behaviour in relation to any transaction that is or is likely to be regulated by the Code).

113. In practice, the Panel normally receives copies of all information during the takeover notice period (although, sometimes only after prompting by the Panel executive). However, there have been a number of instances where the Panel has become aware of important information that ought have been provided to it under rule 47(4), only by reviewing the news media or announcements on the stock market. This leaves a risk that important information may be overlooked, and this could hamper the Panel's enforcement role.

114. In addition to rule 47(4), there are a number of rules in the Code which impose requirements on the "offeror" during the takeover notice period. These include:

- Rule 41(A): which sets out the "offeror's" notification obligations when the takeover notice is sent;

- Rule 43A: which requires the "offeror" to send to the target company a notice of the record date of the offer;

115. The references to the "offeror" in these rules are inconsistent with the definition of "offeror" in rule 3(1) of the Code: "a person who makes an offer". During the takeover notice period, no person "makes" an offer and, indeed, no offer might ultimately be made. This inconsistency has little practical significance. The Code assumes, and market practice usually is, that all references to "offeror" in the Code are understood to include a prospective offeror (during the takeover notice period), with a corresponding understanding of "offeree".

116. Nevertheless, a drafting anomaly exists, particularly when "offeror" and "offeree" are compared to the definition of "target company" in rule 3(1). That definition explicitly makes reference to the takeover notice.

117. The drafting anomaly creates a small, residual, confusion about the extent of the obligations under rule 47(4).

Options

118. The following options have been identified for addressing these drafting inconsistencies.

Option one: maintain the status quo

119. Under this option, the existing definitions of “offeree” and “offeror” in rule 3(1) of the Code would remain in place.

120. To date, the status quo has not resulted in any substantial problems. Market practice appears to assume that all references to “offeror” and “offeree” in the Code include prospective offerors or offerees. In respect of the information-sharing requirements in rule 47(4), voluntary compliance almost always ensures that the Panel receives copies of all relevant offer-related information, so far as the Panel is aware.

121. However, there have been instances where the Panel has not received information that it should have. This problem would not be resolved by maintaining the status quo.

Option two: amend the Code (preferred option)

122. The Panel’s preferred option would be to recommend to the Minister that the definitions of “offeror” and “offeree” in rule 3(1) of the Code be amended to also include prospective offerors and offerees in respect of a target company that has received a takeover notice, along the following lines::

Offeree *means a person to whom an offer is made or who is a shareholder in a target company that has received a takeover notice*

Offeror *means a person who makes an offer, and includes a prospective offeror who sends a takeover notice*

123. The preferred option would remove the drafting inconsistencies in the Code. This would meet the Panel’s objective to remove inconsistencies in the wording of the Code and other drafting anomalies.

124. Moreover, the prospective offeror would clearly be obliged to provide copies to the Panel of all statements and information that are published or sent to (prospective) offerees during the takeover notice period. This would assist the Panel with performing its enforcement functions and meet the policy objective of ensuring that the market for takeovers of Code companies is efficient and competitive.

QUESTIONS

1. Do you agree that there is a problem with the definitions of “offeror” and “offeree”?

2. Do you support the Panel’s preferred option? If so, why? If not, why not?

3. Do you have any other comments or suggestions which you would like to contribute?

Schedule 1, clause 14(2)(b) – redundant words

Problem identification

125. As noted in Section One of this discussion paper, an offer document must include a general statement about any material changes that the offeror is likely to make to the target company.[46] However, the offeror does not have to provide this statement if:

(a) The offer is conditional on the offeror acquiring 90% or more of the voting rights (which would give the offeror dominant owner status and entitle it to invoke the compulsory sale provisions of the Code to acquire the remaining voting securities in the Code company); and

(b) This condition cannot be waived *or varied*.[47]

126. The inclusion of the words "or varied" in clause 14(2)(b) is a drafting error. Rule 27 of the Code limits the kinds of variations that an offeror is permitted to make to the offer during the offer period; that is, the offeror may increase the consideration, add cash or a cash component to the consideration, extend the offer period (within prescribed limits), and, if so, extend the specified date by which the offer must become unconditional. No other variations to the offer are allowed.

127. Therefore, if the offer included a condition within the terms contemplated by clause 14(2)(b), such a condition could not be varied under the Code. Accordingly, the use of the words "or varied" in the relevant clause is redundant. This potentially creates confusion as to whether it is permissible to vary a 90% minimum acceptance condition.

Options

128. The following options have been identified for addressing the problem:

Option one: maintain the status quo

129. The drafting anomaly would remain if the status quo was maintained. Accordingly, it is not the Panel's preferred option to maintain the current wording of clause 14(2)(b) of Schedule 1 of the Code.

Option two: amend the Code (preferred option)

130. The Panel's preferred option for this drafting anomaly is to recommend to the Minister that clause 14(2)(b) of Schedule 1 of the Code be amended to remove the redundant words "or varied". This is an inconsequential change to the regulations. It will remove any potential risk of confusion and solve the problem identified above. It

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[46] Clause 14(1), Schedule 1 of the Code.
[47] Clause 14(2), Schedule 1 of the Code.

meets the Panel's policy objective to remove inconsistencies in the wording of the Code and other drafting anomalies.

QUESTIONS

1. Do you agree that the words "or waived" in clause 14(2)(b) of Schedule 1 of the Code are unnecessary?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you have any other comments or suggestions which you would like to contribute?

Schedule 2, clause 18 – availability of annual reports

Problem Identification

131. Schedule 2 of the Code prescribes the information that a target company must include in the target company statement that it issues in response to a takeover offer.

132. Clause 18(1) of Schedule 2 provides that the target company statement must include:

A statement that the offeree is entitled to obtain from the target company a copy of the most recent annual report of the target company.

133. Clause 18(6) provides that:

annual report *means*

(a) if any voting securities of the target company are quoted on the registered exchange's market, the annual report and financial statements (including the auditor's report on those financial statements) that the target company is required by the registered exchange to send to the target company's equity security holders; or

(b) if paragraph (a) does not apply, the annual report prepared in accordance with sections 208(1) and 211(1) of the Companies Act 1993 and sent to shareholders of the target company under section 209 of the Companies Act 1993.

134. Sections 209, 209A, and 209B of the Companies Act provide that a company may make available its annual report to shareholders by electronic means. If a shareholder requests a hard copy of the annual report, the company must sent it. Otherwise, the company must make the annual report available by electronic means (such as by keeping it posted on its website). In the case of listed companies, the NZX requires the issuer to also make its annual reports available to shareholders by electronic means in accordance with the relevant provisions of the Companies Act.[48]

135. The provisions of the Companies Act that relate to electronically available reports were introduced in 2007 by the Companies Amendment Act (No. 2) 2006. As a result, there is now an inconsistency between the Code and the Companies Act. The Code refers to the annual report that is required to be "sent" by the target company., whereas the Companies Act permits annual reports to be made available on websites. Although a minor matter, there is a potential ambiguity in that the Code does not reflect the flexibility in the Companies Act for a target company providing its annual report by electronic means.

[48] Rule 10.5.4, NZX Listing Rules.

Options

136. The following options have been identified for addressing the problem:

Option one: maintain the status quo

137. One option would be to maintain the status quo. However, this would mean a drafting anomaly would continue to exist in the Code. This does not meet the Panel's objective in undertaking a review of the Code to remove inconsistencies and ambiguities of drafting. Accordingly, maintenance of the status quo is not the Panel's preferred option.

Option two (preferred option): amend the Code

138. The Panel's preferred option is to recommend to the Minister that the Code be amended (along the lines shown by underlining, below) such that clause 18(6) of Schedule 2 provides:

annual report *means*

(a) if any voting securities of the target company are quoted on the registered exchange's market, the annual report and financial statements (including the auditor's report on those financial statements) that the target company is required by the registered exchange to make available to the target company's equity security holders; or

(b) if paragraph (a) does not apply, the annual report prepared in accordance with sections 208(1) and 211(1) of the Companies Act 1993 and made available to shareholders of the target company under sections 209, 209A, and 209B of the Companies Act 1993.

139. The proposed amendment would remove the words "send" and "sent" and replace them with the words "make available" and "made available", in clause 18(2)(a) and (b), respectively. The proposed new wording clearly captures the possibility that the target company may provide its annual report, in accordance with its obligations under the Companies Act, and, in the case of listed companies, the NZX Listing Rules, by electronic means.

140. Accordingly, the proposed wording removes any ambiguity in the Code and the inconsistency between the Code and the Companies Act. This meets the Panel's policy objective. Therefore, the proposed amendment to the Code is the Panel's preferred option.

QUESTIONS

1. Do you agree that the definition of "annual report" in clause 18(6) of Schedule 2 of the Code needs updating?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you have any other comments or suggestions which you would like to contribute?

Disclosure of trading behind nominees

Problem Identification

141. Clause 6(1)(b)(ii)(A) and (B) of Schedule 2 of the Code requires the target company statement to disclose in respect of any person (to the knowledge of the company) who holds or controls 5% or more of any class of equity securities in the target company the following:

   (A) in the case of a single transaction in any week to which this subclause applies, the number of securities, the consideration per security, and the week of each transaction; and

   (B) in the case of multiple transactions in any week to which this subclause applies, the total number of securities acquired or disposed of in a week, in each class, and the weighted average consideration per security per class.

142. This clause requires the target company to disclose (to the best of its knowledge) all trading by the substantial security holders of the company in the six months prior to the date of the target company statement. The purpose of this provision is to inform the offerees and the market of any dealings in the target company's securities by the major shareholders.

143. Although the requirement for *target companies* to disclose trading in equity securities is a new requirement as a result of the technical amendments to the Code made in 2007, these disclosures were required to be made by *offerors*, pursuant to Schedule 1 of the Code, prior to 1 July 2007. However, the earlier requirements did not allow for any aggregation of trading.

144. In New Zealand, a substantial proportion of the voting securities in listed companies are traded through the NZClear settlement system.[49] Under this system, New Zealand Central Securities Depository Limited ("NZCSD"), a custodian owned and operated by the Reserve Bank of New Zealand, is the legal holder of securities on behalf of the members of the NZClear system (i.e., the beneficial owners of the securities or agents of the beneficial owners), who are typically financial institutions. All transactions in respect of the particular securities between the members of NZClear are settled by way of account. The actual securities remain a holding of NZCSD.

145. It is likely, given its custodial function, that in respect of many listed Code companies in New Zealand, NZCSD will hold 5% or more of the class of equity security under offer. Although NZClear is a substantial provider in the custodial services market, there may be other custodians in a similar position. Accordingly, the target company statement is required to disclose trading in the securities of the target company by those custodians. However, the custodians, as custodians, do not *control* the securities which they hold. Indeed, the individual beneficial owners of the securities (who are

[49] Reserve Bank of New Zealand *Overview of NZClear* (updated June 2010), available online at http://www.rbnz.govt.nz.

likely to be clients of the financial institutions who are members of the NZClear system)[50] who do control the shares may have a voting interest of less than 5%. Nevertheless, the trading information will have to be disclosed under clause 6 of Schedule 2. This information is unlikely to be of value to the offerees.[51]

146. Accordingly, it appears to the Panel that there is no benefit in the Code requiring a target company statement to disclose the trading data of the clients of a custodian (such as NZCSD) who hold or control sub-5% parcels of the class of equity security under offer. The data does not relate to substantial owners of the securities under offer.

Options

147. The following options have been identified for addressing the problem.

Option one: maintain the status quo

148. The first option would be to maintain the status quo.

149. The status quo would maintain the disclosure of information (trading data) that may be of little value to the offerees and the market. It could result in the target company statement becoming cluttered with the details of share trading data about the clients of a custodian holder (in the case of NZCSD, there could be a large volume of such data if the target company is a significant listed company in New Zealand).

150. Moreover, the purpose of the disclosure rule in clause 6 of Schedule 2 is to ensure that the offerees are informed of any trading in the target company's securities by substantial shareholders. Although a custodian may hold 5% or more of the target company's shares, a custodian itself has no control over those shares; it is a mere conduit. Accordingly, the maintenance of the status quo would appear to be inconsistent with the purpose of the relevant provision of the Code.

151. One of the Panel's objectives in carrying out a technical review of the Code is to improve clarity and certainty about the requirements of the Code through removing inconsistencies in the wording of the Code and other drafting anomalies. The maintenance of the status quo would not satisfy this objective.

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[50] It is also quite common to have 'layers' of nominees between the beneficial owners and the custodian who holds the securities.

[51] However, trading data in respect of any beneficial owner who controls 5% or more of the class of equity security under offer (which are held through a custodian) in the target company should be disclosed in the target company statement, because of the reference to "controlled" in clause 5(1) of Schedule 2.

Option two (preferred option): amend the Code

152. The Panel's preferred option is to recommend to the Minister that the Code be amended to include a proviso to the disclosure obligation in clause 6 of Schedule 2 of the Code along in the following lines:

6 Trading in target company equity securities

…

(3) For the purposes of subclause (4), a ***professional custodian*** *means a person who, in its ordinary course of business, holds securities directly or indirectly on behalf of the beneficial owner of the securities;*

(4) If a person referred to in subclause (1) [i.e. in being, any person holding or controlling 5% or more of the class(es) of equity security under offer] holds equity securities of any class of the target company as a professional custodian, the target company statement may omit information for the purposes of subclause (1) in respect of a beneficial owner of the equity securities held by the professional custodian in that class, if that beneficial owner controls less than 5% of the total equity securities in that class in the target company.

153. The advantage of the preferred option over the status quo is that it would ensure that the target company statement would only contain share trading data in respect of the "true" substantial security holders, and not also data on the trading of beneficial owners with less than 5% who were the clients of custodian shareholders.

154. The target company statement would still be required to disclose trading information in respect of any persons who controlled 5% or more of the voting rights in the target company, even if those persons' securities were held by a professional custodian.

155. Accordingly, the preferred option meets the Panel's policy objective of ensuring that investors in New Zealand Code companies are fully informed in respect of an offer for their voting securities.

QUESTIONS

1. Do you agree that a target company statement should not have to disclose trading data by those clients of a custodian who control less than 5% of the voting rights in the target company?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you have any other comments or suggestions which you would like to contribute?

Variation of offer if more complete information in respect of securities is available

Problem Identification

156. The Code prescribes a two-step process for the making of a takeover offer. Firstly, the prospective offeror issues a takeover notice which states that the offeror intends to make an offer and attaches a draft offer document that contains its draft terms and conditions.[52] Secondly, in the time period beginning 14 days, and ending 30 days, after the issuing of the takeover notice, the offeror formally makes its offer.[53]

157. The offer must be on the same terms and conditions as those set out in draft form in the document that accompanies the takeover notice except for:[54]

(a) Any conditions that have been waived or satisfied;

(b) Any variations to which the directors of the target company have given their prior written approval;

(c) Any variation that extends the offer to an additional class or classes of security; and

(d) Any consequential amendments.

158. The target company must, no later than two days after it receives a takeover notice, provide the offeror with a "class notice" which contains sufficient information about each class of equity security (in the case of a full offer)[55] or voting security (in the case of a partial offer)[56] to enable:[57]

(a) The offeror to formulate an offer; and

(b) An independent adviser to provide a report (or amended report) which certifies that the offer is fair and reasonable as between the classes of securities.

159. On 1 July 2007, a new provision (rule 44(3) of the Code) was inserted into the Code which enables the offeror to vary the offer from the draft that accompanied the takeover notice, to include in the offer an additional class or classes of security, without the offeror having to obtain the prior consent of the directors of the target company.[58] The new provision was introduced to address the Panel's concern that any difficulties faced by an offeror in identifying all the classes of securities of a target company could discourage takeover bids in some circumstances (such as a hostile

[52] Rule 41 of the Code.
[53] Rule 43B of the Code.
[54] Rule 44(1) of the Code.
[55] A full offer must include, whether they carry voting rights or not, an offer for all classes of equity securities in the target company: rule 8(2) of the Code.
[56] A partial offer must be made to all holders of voting securities in the target company: rule 9(2) of the Code.
[57] Rule 42A of the Code.
[58] Rule 44(3) of the Code.

takeover) or, alternatively, could impose unnecessary compliance costs on an offeror should it have to recommence an offer to include an additional class or classes of securities.

160. There is a possible scenario (which had not been borne in mind when the provision was introduced) where the new provision fails to meet the Panel's objective: an offeror may have access to *incomplete* information in respect of a class or classes of security of the target company. The scenario could cause two problems for a prospective offeror:

(a) The offeror gives a takeover notice which includes the draft terms and conditions of an offer based on the incomplete information. If the offer is made for more than one class of security, the takeover notice would have to include an independent adviser's report which certifies that the offer is fair and reasonable as between the classes (based on the information available about those securities). In light of new information received by the offeror in the class notice from the target company, the offeror may vary the terms of its offer. The variation would require the prior written approval of the directors of the target company, because this situation falls outside of the terms of rule 43(3). The independent adviser's report may also (depending on the nature of the variation) be inaccurate. The offeror cannot obtain an amended report because that is only permitted in cases where the offer is being varied to include an *additional* class or classes of securities.

(b) The offeror could withhold making an offer for the class or classes of security in respect of which only limited information exists (and once the offeror had obtained the class notice, it could vary its offer to include the additional class or classes of security). The problems with this approach are two-fold: Firstly, such an offer may breach the Code. A full offer must include all classes of equity securities in the target company or, in the case of a partial offer, all classes of voting securities. Secondly, the offeror could be misleading the market if it deliberately makes an offer for a class or classes of security with the intention of including another class or classes at a later date.

161. It is likely that the Panel could address these problems in practice by the exercise of its exemption power under section 45 of the Takeovers Act. Prospective offerors would apply for an exemption when they receive the class notice with the additional information. The Panel might grant it on conditions that replicated the current rules, except they would be redrafted in the exemption to expand the variations that may be made to the terms of the offer without the target company directors' prior approval. This would accommodate the new information that had come to light in the class notice from the target company. However, this would be cumbersome for the offeror and would result in the offeror effectively paying (in terms of time and money in the making of an application for an exemption) for a drafting lacuna in the Code.

Options

162. The following options have been identified for addressing the problem:

Option one: maintain the status quo

163. The first option is to maintain the status quo.

164. However, this option would leave the problem unresolved. The problem undermines the Panel's intention when it recommended that rule 44(3) be inserted into the Code to free up the offer process for surprise or hostile takeovers. The problem of incomplete information may discourage prospective offerors from undertaking anything but a "friendly" takeover offer. Additionally, the problem may result in increased compliance costs for prospective offerors who seek to be exempted from the Code, or otherwise are left having to begin their takeover again.

165. The Panel does not see any advantages in maintaining the status quo.

Option two (preferred option): amend the Code

166. The Panel's preferred option is to recommend to the Minister that the Code be amended to make rule 44(3) apply, not only to additional classes of securities, but also to new information about classes that were already known by the offeror. This would require the re-drafting of rule 44(3) along the following lines:

> *(3) The offer may be varied to extend the offer to an additional class or classes of security or to amend the terms or conditions of the offer relating to a class or classes of security, without the approval of the directors of the target company if –*
>
> *(a) the class or classes were included in the class notice given under rule 42A but were either:*
>
> *(i) not included in the terms or conditions contained in or accompanying the takeover notice; or*
>
> *(ii) were included in the terms or conditions contain in or accompanying the takeover notice but those terms or conditions did not accurately or completely account for the information in the class notice given under rule 42A.*

167. The advantage of the preferred option is that it would enable the offeror to vary its offer, and obtain an amended report from an independent adviser on the fairness of the offer, in respect of any class or classes of securities in respect of which the offeror has obtained additional information as a result of the Code's class notice procedure. This should facilitate the making of takeover offers and decrease the potential compliance costs.

168. The Panel's objective in carrying out the review of the Code is to improve clarity and certainty about the requirements of the Code through removing inconsistencies in the

wording of the Code and other drafting anomalies. The preferred option achieves this objective.

QUESTIONS

1. Do you agree that there is a problem for offerors who make an offer based on incomplete information in respect of a class of securities on issue in the target company?

2. Do you support the Panel's preferred option? If so, why? If not, why not?

3. Do you have any other comments or suggestions which you would like to contribute?

Definition of "director" and the Limited Partnerships Act 2008

Problem Identification

169. Section 2 of the Takeovers Act defines a "director" as follows:

director means, in relation to a company or other body corporate, any person occupying the position of a director of the company or body by whatever name called

170. Rule 3 of the Code defines a "director" as follows:

***director*,—**

(a) in relation to a company, means a person occupying the position of a director of the company, by whatever name called; and

(b) in relation to a partnership (other than a special partnership), means a partner; and

(c) in relation to a special partnership, means a general partner; and

(d) in relation to a body corporate, or unincorporate, other than a company, partnership, or special partnership, means a person occupying a position in the body that is comparable with that of a director of a company; and

(e) in relation to any other person, means that person; and

(f) includes a person in accordance with whose directions or instructions a person referred to in paragraphs (a) to (d) may be required or is accustomed to act in respect of the exercise of duties or powers as, or comparable to those of, a director

171. The definition in the Act is very broad and does not specify the kind of legal entity in respect of which a person is acting as a director. The definition in the Code, however, is very specific. It lists the various kinds of legal entities (such as companies, partnerships and special partnerships) in relation to which a person may be a director.

172. The Limited Partnerships Act 2008 established a regime in New Zealand for a new kind of legal corporate entity called a limited partnership. A limited partnership consists of at least one general partner and at least one limited partner.[59] The general partner manages the limited partnership.[60] A limited partner is not responsible for management, but may make a capital contribution to the limited partnership.[61] Limited partnerships must be registered on the public register of limited partnerships.[62]

[59] Limited Partnerships Act 2008, s 8.
[60] Ibid, s 19
[61] Ibid, s 20.
[62] Ibid, s 51.

173. The Panel has noted that limited partnerships are becoming an increasingly popular means for an offeror to carry out a takeover offer under the Code. Two of the most recent takeovers used a limited partnership as the offeror vehicle. The general partner of these offerors was established as a limited liability company under the Companies Act 1993 and consists of a person, or persons, who act as directors of the general partner. In effect, these persons are the "directors" of the limited partnership acting as the offeror.

174. The definitions of director in the Code and the Act do not recognise New Zealand's new limited partnership regime. The definition of "director" in the Act is arguably broad enough to include the general partner of a limited partnership. The definition of "director" in the Code is prescriptive (it explicitly lists the various entities in respect of which a person is a director for the purposes of the Code), and does not include limited partnerships. However, the catch-all in paragraph (f) of the Code's definition would cover the directors of a general partner.

175. When the Limited Partnerships Act was enacted, it provided for a number of consequential amendments to definitions of "director" in various pieces of legislation.[63] The Takeovers Act and Code were overlooked in these provisions.

176. Given the increasing use of limited partnerships in takeovers transactions, to provide certainty and clarity for the parties to a takeover, the Act and Code should recognise the limited partnerships regime. At present, the Act and Code do not do this.

Options

177. The following options have been identified for addressing the problem:

Option one: maintain the status quo

178. The first option is to maintain the status quo.

179. This option would leave the problem unresolved. Although the definition of director in the Takeovers Act could include a limited partnership, the definition in the Code would remain deficient. That definition is prescriptive and, accordingly, it would be inconsistent for it to exclude limited partnerships while still referring to other forms of legal entities.

180. In light of the increasing popularity of limited partnerships in takeover transactions, the deficiency in the definition would reduce clarity and certainty for potential offerors and other interested stakeholders. Accordingly, maintaining the status quo does not satisfy the Panel's policy objective.

Option two: amend the Act and the Code

181. The Panel's preferred option is to update the definitions of "director" in both the Act and the Code by recommending to the Minister that they be amended.

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[63] Ibid, s 121.

182. The amendment to the Code would add a reference to limited partnerships in the definition of "director" in rule 3 of the Code (changes are shown in underlining):

***director**,—*

(a) in relation to a company, means a person occupying the position of a director of the company, by whatever name called; and

(b) in relation to a partnership (other than a special partnership <u>or limited partnership</u>), means a partner; and

(c) in relation to a special partnership <u>or limited partnership</u>, means a general partner; and

(d) in relation to a body corporate, or unincorporate, other than a company, partnership, ~~or~~ special partnership <u>or limited partnership</u>, means a person occupying a position in the body that is comparable with that of a director of a company; and

(e) in relation to any other person, means that person; and

(f) includes a person in accordance with whose directions or instructions a person referred to in paragraphs (a) to (d) may be required or is accustomed to act in respect of the exercise of duties or powers as, or comparable to those of, a director

183. The amendment to the Act would remove the existing definition of "director" in section 2 of the Act and replace it with the definition of director (including the reference to limited partnerships) used in the Code.

184. The proposed amendments to the Code and the Act are the Panel's preferred option because they directly address the problem identified above. The definition of "director" in the Code omits a reference to limited partnerships, even though it prescribes a list of other legal entities in respect of which a person may be a director. This is inconsistent.

185. The Limited Partnerships Act included consequential amendments to a number of pieces of legislation that referred to special partnerships in their definitions of "director", by adding "*or limited partnership*" after the words "*special partnership*". Unfortunately, the Takeovers Act and Code were overlooked when the policy process was undertaken for the Limited Partnerships Act.

186. The preferred option will add certainty and clarity by including limited partnerships in the Code and the Act. This meets the Panel's policy objective of removing inconsistencies in the wording of the Code and other drafting anomalies.

QUESTIONS

4. Do you agree that there is a problem with the definition of "director" in the Act and the Code? Should these definitions reflect the Limited Partnerships Act 2008?

5. Do you support the Panel's preferred option? If so, why? If not, why not?

6. Do you have any other comments or suggestions which you would like to contribute?