

Mergers & Acquisitions Summit

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Update from the Takeovers Panel

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Good morning

I would expect that all of you here today, with your obvious interest in the takeovers market, are aware that John King has stepped down from chairing the Takeovers Panel. I would like to take this opportunity to pay tribute to John for his long involvement with the regulation of takeovers from the initial Panel set up in 1993, the subsequent development and drafting of the Code, the reactivation of the Takeovers Panel in 2000 and the introduction of the Code in 2001. Since then he has led the Panel through almost six years of operation during which time it has been tried and tested, and generally well received. Takeovers in the New Zealand market now take place in an orderly way and shareholders are kept well informed of, and involved in, the takeover process.

My appointment as Chairman of the Panel does not herald any change. It will be business as usual. This is not surprising since, having worked closely with John King on the development, implementation and enforcement of the Code for more than a decade in my capacity as Deputy Chair, we share the same philosophy on the application of the Code and its underlying principles.

I am assuming the Chair when it is fair to say that Code is “bedded down” in the sense that the manner in which the Code is applied and its provisions interpreted is largely settled. The market understands the Code and the Panel’s approach to interpretation and enforcement very well. We recognise the importance to the market of maintaining consistency in this approach. The change in Chairman along with three new members will not mark any departure from what has gone before. This will contribute to market certainty.

That is not to say that there will not be changes in the future. Commerce and the takeovers market is a dynamic environment where change is a part of the landscape. In the face of change the Code will be tested and the Panel may need to respond. Any such response will only be made in a manner consistent with the principles of the Code and, to the extent

possible, in consultation with the market. The Panel will continue to work with the market as it has always done. We pride ourselves on providing certainty and, subject to the legal limitations of the Takeovers Act and the Code, will always strive for sensible commercial outcomes.

Today's topics are intended to give some insights into current issues – firstly technical amendments to the Code, secondly schemes and amalgamations, and thirdly changes to takeovers law and the Panel's powers.

Technical amendments to Code

Over the past five and a half years we have encountered parts of the Code that raise issues for its workability. These have now been addressed by technical amendments which will come into force this year when regulations are settled. Some are relatively minor but all are important. The Panel will publish a *Code Word* explaining all the technical amendments in detail. For this reason this paper will cover just three - rule 22 reports, offers unconditional as to levels of acceptance, and compulsory acquisition.

More than one class of securities – rule 22 reports

Rule 22 of the Code currently requires the offeror to obtain an independent adviser's report on the fairness and reasonableness of the terms and consideration being offered as between two or more classes of the target's equity securities. The report must accompany the takeover notice sent to the target company, and must be sent to target company shareholders with the offer document. The practical consequence is that where the target company statement does not accompany the offer (which is usually the case), shareholders can be misled into thinking that the rule 22 report is a report on the merits of the offer which it is not.

The technical amendment requires the rule 22 report to be sent to offerees with the target company statement and rule 21 report on the merits of the offer. This has the benefit of ensuring that shareholders are fully informed when making a decision as to acceptance or not of an offer, and are not misled by a report on the fairness between classes. The rule 22 report must, as with current practice, accompany the takeover notice.

More than one class of securities – terms in offer documents

The combined effect of several rules of the Code require a bidder to determine all of the classes of target company securities on issue when the takeover notice is sent to the target company. This can be a problem, particularly if a takeover is hostile or unfriendly. For example, the bidder may be unaware of several classes of employee share options on issue.

If there is more than one class of equity securities (in a full offer) or more than one class of voting securities (in a partial offer) a rule 22 report must be sent with the takeover notice.

Rule 44 of the Code requires the offer that is sent to shareholders to be on the same terms and conditions as those in the draft offer which accompanies the takeover notice.

An offeror in an unfriendly bid will not be able to comply with this requirement if after sending the draft offer, the offeror becomes aware of a further class of shares to which the offer will need to be extended. This is because the variation must first be approved by the directors of the target company.

In a hostile takeover the target company directors could refuse to allow a bidder to amend its offer document to include a class of securities which the bidder was unaware of when the takeover notice was given. This would effectively require the bidder to start the offer again.

The technical amendment addresses this potential problem by, first, requiring the target company to give the offeror a class notice describing the company's relevant securities within two days of receiving a takeover notice and, secondly permitting the offeror to vary the offer document. The offeror then can add any omitted class or classes of securities to its offer, without needing the target company directors' prior consent. In that case, notice of the variation and an amended rule 22 report must be sent to the target company at least seven days before the date of the offer.

Offers unconditional as to level of acceptances

Under rule 24, as currently drafted, Code offers must be open for acceptance for a specified period of between 30 and 90 days. Offers which, from the outset, are unconditional as to level of acceptances, or which contain such conditions which have been satisfied, can be extended beyond the 90-day maximum period for an additional 60 days.

The 60 day extension exception to this principle was always considered to be a "mopping up" period once any minimum acceptance conditions had been satisfied or waived which would allow offerees to accept in the confidence that the offer would be successful. There is not the same need for this exception to the 90 day maximum period where offers are unconditional at the outset.

The technical amendment makes this distinction. Once in force, offers which from the outset are unconditional as to the level of acceptances can still be extended, but not beyond the 90-day offer period. Offers that have conditions as to the level of acceptances, can, if those conditions are satisfied or waived within the 90-day offer period, be extended by up to 60 days. That extension runs from the day that the minimum acceptance conditions were satisfied or waived, not from the end of the offer period.

Compulsory acquisition

Changes are being made to three areas of the compulsory acquisition rules. They relate to:

- two process matters;
- requirements about the consideration payable under a compulsory acquisition; and
- the threshold for having to pay cash consideration certified as being fair and reasonable by an independent adviser under rule 57.¹

Compulsory acquisition process – where dominant ownership achieved under an offer - timing of acquisition notice

The compulsory acquisition process requires an offeror, who becomes a dominant owner² through acceptances of an offer, to issue an Acquisition Notice. The notice must state whether the outstanding securities will be compulsorily acquired and the consideration payable. Currently it must be issued no later than 30 days after the offeror becomes the dominant owner, whether or not the offer has closed. This can lead to problems and confusion if an offer still has time to run.

This amendment provides that an offeror who becomes a dominant owner by acceptances of an offer must send its acquisition notice no later than 30 days after the end of the *offer period* (instead of 30 days after becoming a dominant owner).

Compulsory acquisition process - calculation of percentage

Rule 56 requires the consideration payable under the compulsory acquisition as the same consideration as paid under the offer if acceptances under the offer represented more than 50% of the equity securities the subject of the offer. The Panel has always taken the view that the rule 56 calculation of the percentage of acceptances should exclude acceptances for voting securities controlled by the offeror or held or controlled by the offeror's associates. The amendments address this by expressly excluding such voting rights from the calculation of the percentage of voting rights obtained through acceptances of an offer.

Consideration alternatives – election by outstanding security holders

I stated above that if a person becomes a dominant owner by acceptances of an offer, and if acceptances were received for more than 50% of the class of securities under offer, that rule 56(2) of the Code requires that the consideration payable to compulsorily acquire the

¹ The technical amendments have made a number of changes in the area of compulsory acquisition under Part 7 of the Code. In the interests of brevity, I discuss each of these changes only once, and do not explicitly refer to a change that has already been discussed even though, in practice, it may have implications for another area of compulsory acquisition that is discussed.

² Compulsory acquisition occurs under the Code when a target company shareholder becomes a dominant owner. The Code defines **dominant owner** as “... a person who, after this code comes into force, becomes the holder or controller, or 2 or more persons acting jointly or in concert who, after this code comes into force, become the holders or controllers, of 90% or more of the voting rights in the code company (whether by reason of acceptances of an offer or otherwise)”.

outstanding securities must be the same as the consideration provided under the offer for securities in the same class.³

This requirement can have interesting ramifications where the offer has alternative consideration options. In that case the consideration under compulsory acquisition must be the consideration payable under the offer if an accepting offeree did not choose an alternative. This has been called the “default consideration”. If the offer had no default consideration provision, the compulsory acquisition consideration must be the consideration option with the greatest cash component. In practice, the consequence is that, if an offeror includes an unattractive or unfair default consideration in its offer, it could coerce shareholders to accept a takeover offer in order to avoid being compelled to take the default consideration under compulsory acquisition.⁴

The amendments address this potential for coercion. Outstanding security holders will be able to nominate a consideration alternative in response to the Acquisition Notice and the dominant owner must provide the nominated consideration. However, if an outstanding security holder does not nominate a consideration alternative, then the usual default consideration rules will apply.

Consideration where 50% or less acceptances of takeover offer – role of independent adviser

The preceding discussion has addressed the consideration payable under compulsory acquisition where acceptances were received under an offer for more than 50% of the securities the subject of the offer. Rule 57 as currently drafted sets the consideration to be paid under compulsory acquisition if rule 56 does not apply. This will occur where the compulsory acquisition threshold was reached outside an offer (for example by “creep”) or under an offer in respect of which acceptances represented 50% or less of the securities to which the offer related). In these circumstances, rule 57(1) currently requires an independent adviser to certify as fair and reasonable a **cash sum** to be paid for compulsorily acquiring the outstanding securities.

Under the amendments, an independent adviser is no longer required where a person becomes the dominant owner through an offer that was for cash or had a cash alternative, and acceptances were received for 50% or less of the securities offered. The reason for this is because the outstanding security holders received an independent adviser report on the merits of the *offer*, under rule 21 under the offer. That report will have given advice on the value of the target company and of the shares offered. However, outstanding security holders who did

³ The Code defines **outstanding securities** as “... *all the equity securities in the code company that the dominant owner does not already hold or control*”.

not accept into the offer will still have the right to object to the price paid for the compulsory acquisition of their shares, under the objection procedure in rule 57.

This change only affects compulsory acquisition that follows a takeover offer. It does not affect compulsory acquisition where a person becomes a dominant owner outside an offer. This could occur through “creeping” to the 90% threshold, or through an allotment or acquisition. In the latter circumstances an independent adviser is still required to certify as fair and reasonable the cash sum that must be paid for the outstanding securities.

There are many other technical amendments. These will be explained in an issue of *Code Word* to be published when the regulations are settled and the amendments come into force.

Schemes and amalgamations

It is well known that the Panel has been concerned for some time about the increasing use of schemes of arrangement and amalgamations under the Companies Act 1993 to avoid the provisions of the Code when seeking to change the ownership or control of code companies.

The issue is not new. As early as 2003, the Panel published a policy statement in response to the use of schemes of arrangement which triggered the Code and for which exemptions had been sought. The manner in which schemes and amalgamation have been used since that time to avoid the Code in effecting a control change has forced the Panel to rethink that policy.

The Panel recognises the need for parties to be free to structure transactions in a manner which is appropriate to achieve their desired commercial result. The Panel has no desire to prevent the use of schemes or amalgamations. In simple terms all the Panel wants to achieve is:

- (1) a recognition that schemes and amalgamation may effect changes of control of code companies; and
 - (2) in those cases, shareholders should have similar protections for those provided to the shareholders of a code company when a change of control is effected by a code transaction.
- The Panel considers that this consistency could be achieved, without affecting the ability of commercial parties to use the alternative mechanisms of schemes and amalgamations, by amending the Companies Act so that in respect of code companies

⁴ The right of outstanding security holders to object to the compulsory acquisition consideration arises only under rule 57. If the compulsory acquisition consideration is determined under rule 56 there is no right of objection available.

schemes of arrangement and amalgamations are carved out of the Takeovers Code completely; and instead

- under schemes the court is required to give consideration to (but is not bound by) the principles of the code and the recommendations of the Panel, and in the case of amalgamations that the approval of the Panel be required to the terms of the amalgamation.

In the recent Dominion case the Court recognised the Panel has standing to be heard on applications by parties seeking approval for schemes of arrangement. The Panel will seek to be heard by the High Court on schemes of arrangement involving code companies at the stage that initial orders are being made. The Panel's preference though is for a change to the law, and will continue to press for this.

If a scheme has been granted an exemption by the Panel, the conditions of that exemption may mean that the Panel does not need to seek to be heard by the Court.

Takeovers Amendment Act 2006 – misleading and deceptive conduct; expanded powers for Panel and Court

The Takeovers Amendment Act 2006 altered the Takeovers Act 1993 and the Takeovers Code in three significant areas:

- the definition of “*code company*” has been changed;
- the Code and Act will specifically empower the Panel and Court to deal with misleading and deceptive conduct in relation to all Code-related transactions and events (these provisions are expected to come into effect very soon); and
- the Panel's enforcement powers, and the penalties and remedies available to the Court, have been increased and broadened.

Changes to the definition of Code company

The new law has changed the definitions for applying the Code to both listed and unlisted companies.

Listed Companies

Previously for listed companies a *code company* or a *specified company* was a company that was listed on a registered exchange or that was listed during the past 12 months.

This has meant that all listed companies even those whose listing arose by reason of the quotation of non-voting securities were caught by the Code. Often these companies could be wholly-owned subsidiaries of overseas companies.

This result was unintended and accounts for the exemptions granted by the Panel to a number of companies over recent years.

This problem has been addressed by the Amendment Act. Under the new definitions the Code applies to any company that –

- is listed on a registered exchange *and has securities that confer voting rights quoted on that exchange*; or
- has been listed and had securities that confer voting rights quoted on that exchange in the last 12 months.

Unlisted Companies

For unlisted companies, the old definition was *50 or more shareholders and \$20 million or more of assets*. The new definition removes the asset threshold so that the Code and Takeovers Act will apply to every company that has 50 or more shareholders. This is in line with Australian legislation.

The effects of these definition changes are:

- Firstly, any listed company with *only* non-voting securities quoted (for example, debt securities) is no longer a *code company* or *specified company* unless it has 50 or more shareholders. The 12-month ‘look back’ for previously listed companies applies similarly.
- Secondly, every company with 50 or more shareholders, regardless of its assets, falls within the *code company* or *specified company* definitions.

In practice, some companies that came within the definitions are now no longer subject to the Code. On the other hand, some small non-listed companies that previously were not subject to the Code are now under its jurisdiction.

Misleading and deceptive conduct

The most significant change to the Code and to the Takeovers Act is the introduction of a prohibition on misleading or deceptive conduct in relation to transactions or events governed by the Code. This prohibition is expected to come into force in mid-2007. The principal new provision is a new rule 64 in the Code.

In summary the new Rule 64 states:

A person must not engage in conduct, in relation to any transaction or event regulated by the Code ... that is misleading or deceptive or likely to mislead or deceive.

This new rule addresses a deficiency in the Code that has limited the Panel’s ability to deal with misleading conduct outside of signed takeover documents.

Because directors and senior executives of the offeror and the target company must certify takeover offer documents and target company statements as being true and correct and not misleading, the Panel has previously been able to take action where these documents were misleading. However, when misleading conduct has occurred outside the signed takeover documents the Panel has not been able to take enforcement action.

The Panel has often been frustrated when it cannot use its enforcement powers to deal with misleading conduct or allegations of misleading conduct during takeovers. As a result, the Panel asked the government to extend the market manipulation provisions, that were originally envisaged only for the Securities Markets Act, to the Takeovers Code.

The new rule 64 is very broad. It is based on section 9 of the Fair Trading Act 1986 - which prohibits misleading and deceptive conduct in trade.

Rule 64 will enable the Panel to exercise its enforcement powers for any misleading or deceptive conduct relating to any transaction or event that is regulated by the Code. Misleading or deceptive conduct that is incidental or preliminary to events or transactions that are or are likely to be regulated by the Code will also be subject to the Panel's enforcement powers.

The term 'misleading or deceptive' has been subject to wide judicial consideration for many years in New Zealand and Australia. It appears frequently in consumer protection legislation. The term occurs in market manipulation provisions of the Australian Corporations Act 2001, and analysis of Australian jurisprudence shows that the Courts apply the consumer protection tests and reasoning to market manipulation cases. It is likely that the same would occur in New Zealand Courts.

In view of that, the Panel is likely to construe the words 'misleading' and 'deceptive' in their natural and ordinary meaning. This has been accepted by the Courts in New Zealand and Australia to mean 'to lead into error'. Accordingly, the Panel may consider Code-related conduct to be misleading or deceptive if it leads, or would be likely to lead, persons into error.

It will also be a criminal offence, under new section 44C of the Takeovers Act, to make or disseminate materially false or misleading statements or information in relation to Code transactions or events.

When the new law comes into force, the Fair Trading Act will no longer apply to conduct that is regulated by the Code and the Takeovers Act. This ensures that the Panel continues as the principal regulator of changes of control in Code companies.

Where misleading or deceptive conduct takes place during a Code-related transaction or event, the Panel will respond in a way which protects the best interests of the market and which advances the most appropriate remedy in the particular case.

Market participants should take considerable care with comments made to the media and to the market when rule 64 is operative. This will be particularly so in a contest for control or an opposed takeover where parties are looking for opportunities to complain to regulators in the hope of gaining a tactical advantage over their opponent. One area which will be the focus of the Panel from its own experience to date is what is referred to as “last and final statements” e.g. statements which are designed to persuade shareholders to accept by stating or implying that if the offer is not accepted, there will be no further extension of an offer period, or a new offer will not be made following the closing of an unsuccessful offer.

The likelihood of tactical complaints has led the Panel to consider threshold tests for deciding whether to act on a complaint about misleading or deceptive conduct. This is also important for the Panel’s efficient and responsible management of its resources

Complainants, especially protagonists in a contested or hostile takeover, are likely to have to do more than merely complain to the Panel. They will need to convince the Panel that its resources would be properly used by acting on the complaint. The Panel may require the complainant to show, for example, that it has something akin to a *prima facie* case, or that the complaint is not vexatious, or to establish that there would be merit in the Panel’s acting on the complaint.

Formal requests to the Panel to convene a section 32 meeting to determine whether there has been a breach of the misleading or deceptive conduct prohibition in the Code will always be taken very seriously by the Panel. However such complainants may have to pay the Panel’s expenses if the section 32 meeting determines that no breach occurred.

Once a breach of the Code has been determined, any remedy ordered by the Panel will be balanced with achieving the right outcome for the market. That may be by requiring a person who makes a misleading statement to provide correcting information to shareholders and to the market. Alternatively they could be required to act in accordance with the terms of the statement. The best solution is likely to be a remedy that keeps a bid on track, unless it is appropriate in the circumstances to stop the bid.

We do not anticipate any real changes from the Panel’s present enforcement practices in the approach that will be taken to dealing with contraventions of rule 64.

Changes to the Panel’s enforcement powers

Section 32 of the Takeovers Act provides the Panel with its enforcement powers.

When the Panel considers that a person may not have acted or may not be acting or may intend not to act in compliance with the Code, it can call a meeting and make temporary restraining orders. These orders, which expire two days after the section 32 meeting, preserve the status quo until the Panel has determined whether the person has complied with the Code.

If the Panel determines that the person has not complied with the Code, it can make restraining orders for up to 21 days. Because of the timelines set by the Code, these temporary orders often result in a complete remedy for the breach. If not, they maintain the status quo for sufficient time for the matter to be determined by the High Court.

Under the new law the Panel can make permanent orders. These will enable the Panel to achieve by enforceable orders what it can already often accomplish with the cooperation from the party who breached the Code. The Panel usually receives cooperation. It seems likely that the permanent orders will increase efficiency where parties in breach are not cooperating with the Panel.

The permanent orders focus on the Panel's power to deal decisively with misleading conduct, by enabling the Panel (without recourse to the Courts) to prohibit or restrict statements or documents, and to direct a person to disclose information or to publish corrective statements, at their own expense.

The Panel's enforcement powers are extended by adding a definition of "contravening" the Code or the Takeovers Act .

Previously the Panel could exercise its enforcement powers only against the person or persons breaching the Code. Secondary conduct, such as aiding, counselling or inducing the actual contravener to breach the Code could only be dealt with in the High Court, by seeking a pecuniary penalty against the person who engaged in the secondary conduct.

The Panel can now make restraining orders and compliance orders in respect of any secondary involvement as well as against the person who actually breached the Code.

Changes to the penalties and remedies available under the Takeovers Act

The Takeovers Act now provides for new compensatory orders as well as the orders that could formerly be sought from the Court. These orders can be made to compensate an aggrieved person for loss or damage suffered as a result of a contravention of the Code.

A new pecuniary penalties regime has also been included in the Act. The maximum amount of a pecuniary penalty is \$500,000 for an individual and \$5,000,000 for a body corporate, for each contravention of the Code. Pecuniary penalties are paid to the Crown.

When the Panel applies for a pecuniary penalty and the Court determines that the Code has been breached, the Court must make a declaration of contravention. The declaration of contravention must be made whether or not the Court also orders the person who contravened the Code to pay a pecuniary penalty.

This means an applicant for a civil remedy order or a compensatory order can rely on the declaration of contravention and is not required to prove the contravention. This will facilitate claims for compensation that might otherwise be too costly to bring to Court.

Offences and Orders

The fines for general offences under the Act, for example, for misleading or attempting to mislead the Panel or for contravening orders made by the Panel, have increased from \$30,000 to \$300,000, for an individual or a company. A fine of up to \$10,000 per day for continuing offences may also be imposed by the Court.

Management banning orders are now available under the Takeovers Act. These prohibit or restrict a person from being a director or promoter or taking part in the management of companies in New Zealand. A person convicted of, for example, misleading the Panel would automatically be banned from managing a company for 5 years. The same will apply for someone making or disseminating materially false or misleading statements - when the new law comes into effect.

Company directors who persistently contravene the Act or Code, the Companies Act, the Securities Markets Act or the Securities Act may be subject to management banning orders made by the High Court. Consequently, even though a director's persistent contraventions may not have resulted in a criminal prosecution, a management banning order can be made against him or her for up to 10 years.

The High Court also has a new power to preserve the assets of a person who is being investigated by the Panel or who has a prosecution or civil proceeding begun against them.

Conclusion

The expanded powers of the Panel in relation to misleading and deceptive conduct will provide a new focus for market participants in terms of the conduct of takeover offers. The Panel will work with the market in the application and implementation of these powers as much as possible.

The technical amendments to which I referred will smooth the application of those parts of the Code which have provided technical challenges. They are not controversial and to a large extent reflect what has been practice for the last few years.

The Panel is a market-based panel. It understands the need for certainty and speed in its decision-making and, within the constraints of the Code and the Act, to achieve sensible commercial outcomes. The recent change in the composition of the Panel will not change these ideals.

On the practical side, I encourage you to take advantage of the Panel's website, its *Code Word* publications and the Panel executive who you will find very knowledgeable and helpful.

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