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PRACTICE NOTES

THIS ISSUE OF CODE WORD IS DEVOTED TO FOUR PRACTICE NOTES ON ASPECTS OF THE TAKEOVERS CODE. EACH NOTE COVERS AN ISSUE WHICH HAS ARISEN IN THE APPLICATION OF THE CODE DURING ITS FIRST YEAR OF OPERATION.

THESE PRACTICE NOTES ARE PROVIDED FOR GUIDANCE ONLY. WHILE THEY SIGNAL THE ATTITUDE OF THE TAKEOVERS PANEL AT THIS TIME THE PANEL IS NOT BOUND BY THESE OR ANY OTHER GUIDANCE NOTES.

PRACTICE NOTE - CLAUSE 13 OF SCHEDULE 1 OF THE CODE

Schedule 1 of the Code prescribes the information that must be included in the offeror's takeover notice and offer document. Clause 13 of Schedule 1 requires that, where the offer is a full offer for cash or an offer with a cash alternative, the offer document is to include a statement as to whether or not any person intends to acquire equity securities in the target company under rule 36. Clause 19 of Schedule 1 requires the offeror, or where the offeror is a company, the offeror's chief executive officer, chief financial officer and two directors, to certify that to the best of their knowledge and belief the offer document is "true and correct and not misleading".

Rule 36 of the Takeovers Code provides that during the offer period:

- the offeror;
- any of its related companies;
- any persons who are acting jointly or in concert with the offeror; and
- the directors of the offeror (together referred to in this note as "the offeror's related parties")

must not acquire equity securities in the target company other than under the offeror's offer except in certain prescribed circumstances. These circumstances are where:

- a) the offeror has made a full offer for cash, or a full offer with a cash alternative; and
- b) the possibility of an acquisition as permitted by rule 36 is disclosed in the offer document; and
- c) the acquisition is made no later than 14 days before the expiration of the offer period; and
- d) the acquisition is made only for cash; and
- e) the acquisition of any equity securities will not result in the offeror's and the offeror's associates' holding or controlling in total more than 20% of the voting rights in the target company

(excluding any equity securities in respect of which the offeror has received acceptances of the offeror's offer) unless the offer has become unconditional; and

f) the acquisition is notified to the Panel immediately.

Some confusion has arisen because of an apparent inconsistency between clause 13 of Schedule 1, which refers to an intention to acquire, and condition (b) of rule 36 which (referring to clause 13) requires disclosure in the offer document of the possibility of an acquisition under that rule. The question arises whether clause 13 of Schedule 1, by using the word "intends", requires the offeror to have formed a definite intention, at the time it despatches its offer document, that it or any of its related parties, will acquire, or will not acquire, equity securities using the exception provided in rule 36. Alternatively, does the wording of rule 36, which only requires that disclosure of the "possibility" of an acquisition under rule 36 be disclosed in the offer document, mean that the offeror and its associated parties do not have to have formed a definite intention to acquire or not to acquire securities outside of the offer at the time the offer document is despatched, but can legitimately form such an intention later?

The Panel recognises that while the offeror may not have formed the intention, at the time it despatches the offer document, of acquiring securities outside the offer under rule 36, it may not wish to be precluded from doing so as the takeover runs its course. Circumstances in a takeover can change rapidly, particularly in a contested takeover, and the Panel accepts that parties' intentions can legitimately change.

The Panel considers that it is permissible for the offeror to satisfy the requirements of clause 13 of Schedule 1, and rule 36, by stating in the offer document that "the offeror has no present intention to acquire equity securities in the target company under rule 36 during the offer period but that there is a possibility that it may do so."

PRACTICE NOTE - CLAUSES 6 AND 7 OF SCHEDULE 1 OF THE CODE

Schedule 1 of the Takeovers Code prescribes information that must be included in an offeror's takeover notice and offer document. Clause 7(1) provides (by reference to clause 6) that if any of:

- a) the offeror; and
- b) any related company of the offeror; and
- c) any person acting jointly or in concert with the offeror; and
- d) any director of any of the persons described in paragraphs (a) to (c); and
- e) any other person (within the knowledge of the offeror) holding or controlling more than 5% of any class of equity securities of the target company

have, during the 6-month period before the date of the offer, acquired or disposed of any equity securities of the target company then:

- the number and designation of the equity securities; and
- the consideration for, and the date of, every such acquisition or disposition

must be stated in the offeror's takeover notice and offer document.

Three issues concerning the application of the requirements of clause 7 of Schedule 1 have arisen in the course of the Panel's review of takeover notices received to date.

First, offerors have experienced difficulty in disclosing the required information about the share trading carried out by those persons holding or controlling more than 5% of the class of equity securities in category (e). These shareholders would be "substantial security holders" in a listed company but many Code companies are not listed. Information about these parties' trading in the shares of Code companies, and the consideration that they have paid or received for equity securities, is not always publicly available even for listed companies. The Code requires disclosure of the consideration for and date of every transaction in the preceding six months. Substantial security holder notices, in respect of listed companies, only have to be filed where there is a change of more than 1% in a person's shareholding, and consideration is not always shown in these notices.

The Panel recognises that it may be impossible for offerors, when they are preparing their takeover notice, to obtain the information required by clause 7 before the notice is sent to the target company and to the Panel. Sometimes this information may only be held by the target company, in other cases only by the relevant shareholders. The Panel recognises that in most cases it would be inappropriate for the offeror to make enquiries about historic share trading of either the target company or its substantial security holders prior to a takeover notice being given as this would signal an imminent takeover.

The Panel will not consider taking any enforcement action against an offeror where it has been unable to provide the information required by clause 7 in the offeror's takeover notice in relation to the holders or controllers of more than 5% of any

class of equity securities of the target company, unless this information is publicly available. The position is different in relation to the actual offer document. Clause 19 of Schedule 1 requires the offeror, or where the offeror is a company, the offeror's chief executive officer, chief financial officer and two directors, to certify that, in respect of the information contained in the offer document, they have made "proper enquiry". The Panel considers that, once the takeover notice is sent, the offeror is then obliged to make "proper enquiry" of the target company and the transacting shareholders to see if they will provide the information required by clause 7 in relation to their shareholding and share transactions. This information must then be included in the offer document. If, despite making proper enquiry, the offeror is still unable to find the information required by clause 7, the offer document should include a statement that appropriate enquiries have been made.

The second issue the Panel has encountered in respect of clause 7 concerns the separate disclosure of the holders and controllers of shares in the target company. The particular issue concerns disclosures about "the offeror" and "any related company of the offeror" in categories (a) and (b). The Code uses the Companies Act 1993's definition of "related company", which generally means all holding companies, sister subsidiaries and own subsidiaries of the offeror.

Example: Able Limited owns all the shares of Beta Limited which in turn owns all the shares in Candy Limited. Candy Limited owns 19% of the shares in Dragon Limited and is making a full takeover for Dragon Limited.

In its takeover notice Candy Limited will disclose that it is the holder of 19% of the shares in Dragon Limited. However, the Panel interprets clause 7 of Schedule 1 to mean that both Able Limited and Beta Limited should be disclosed in the takeover notice as the controllers of the parcel of shares held by Candy Limited.

Care needs to be taken to ensure there is no confusion as to the level of shares held by the offeror and its related companies. However the Panel considers it is important, and consistent with the requirements of clause 7 and the philosophy of the Code, that upstream parties of actual shareholders are disclosed in offer documents.

The third issue the Panel has encountered in respect of clauses 6 and 7 relates to disclosure where the persons referred to in categories (a) to (e) do not hold or control equity securities in the target company. Clause 6(2) provides that, if any of the persons referred to in categories (a) to (e) do not hold or control equity securities in the target company, then a "statement to that effect" should be included in the offer document.

The question arises as to whether clause 6(2) requires disclosure of the identity of all persons in each of category (a) to (e) who do not hold or control equity securities in the target company. Such disclosure would require, for example under category (d), the offeror naming all of the directors of the offeror (category (a)), the directors of all related companies of the offeror (category (b)) and the directors of any person acting jointly or in concert with the offeror (category (c)) and then stating that each

of those named directors did not hold or control equity securities in the target company. The Panel notes that such disclosure could involve naming a very large number of people and companies, particularly if the offeror is part of a global group. The Panel does not consider that such disclosure is practical or necessary.

Typically a takeover notice will list one or more companies or persons who hold equity securities in the target company. The Panel considers that it is then permissible to state that, “apart from the persons listed in the schedule above, none of following hold or control equity securities” in the target company and to then list each of categories (a) to (e) as a generic statement. It is not however necessary to name all the persons and companies which comprise each of the categories.

PRACTICE NOTE - CONDITIONS IN TAKEOVER OFFERS - PAYMENT OF CONSIDERATION

Rule 25 of the Takeovers Code provides that a takeover offer may be subject to conditions, except conditions that depend upon the judgement of the offeror or any associate of the offeror or conditions whose fulfilment is in the power, or under the control of the offeror or any associate of the offeror. If the offer is subject to conditions it must specify a date by which the offer is to become unconditional. There are restrictions in rule 25 as to when this date must be. No condition contained in the offer can have effect beyond the date specified by which the offer is to become unconditional. The offer will lapse if it does not become unconditional by the specified date. If the offer does become unconditional then written notice must be sent to the target company, the Panel and, if the target company’s voting securities are quoted, the New Zealand Stock Exchange.

Rule 33 of the Takeovers Code provides that an offer document must specify the date by which the consideration for accepting the offer must be sent to those persons whose securities are taken up under the offer. The rule requires that the date specified in the offer document must not be later than 7 days after the later of:

- a) the date on which the offer becomes unconditional; or
- b) the date on which an acceptance is received; or
- c) the end of the offer period first specified in the offer.

The intention of this rule is to ensure that offerees who accept a takeover are paid promptly within the context of a takeover. For example an offeror cannot postpone the time of payment of consideration for an offer that is unconditional simply by extending the offer period.

Some offer documents have included, as part of the rule 33 statement, a statement that the date that is specified in the offer document as the last day for the payment of consideration may change “if the offer’s closing date is subsequently extended in accordance with the Code.” The Panel considers that such a statement is not inconsistent with the requirements of rule 33.

Rule 34 of the Code provides that, if the consideration is not sent to persons whose securities are taken up under the offer within the period specified in the offer, then the offeree may withdraw acceptance by notice in writing to the offeror.

However, the offerees’ acceptance may only be withdrawn if:

- a) written notice has been given to the offeror of the intention to withdraw; and
- b) 7 days have expired since the written notice was given; and
- c) the offeree does not receive the consideration from the offeror during that 7-day period.

Some offer documents received by the Panel have included a statement to the effect that “the offeror’s obligations in respect of settlement will be subject to the registration of the transfer of the relevant securities from the offeree to the offeror.” Some of these offer documents have also included a further statement to the effect that “the offeror will present all forms of acceptance and transfer to the target company for registration as soon as possible following the offer being declared unconditional or the conditions being waived in respect of the offer by the offeror”.

Confusion has arisen as to whether statements of the kind referred to in the preceding paragraph are a condition of the offer which must be satisfied before the offer can become unconditional for the purposes of rule 25 of the Code. One view is that such statements merely prescribe the requirements of settlement between the offeror and the offerees and are not a condition of the offer. The other view is that the statements are a condition of the offer.

The Panel considers that such statements are a condition of the offer. As such the offer cannot become unconditional until the condition contained in the statements is either satisfied or waived. The Panel takes this view because the statements have the effect of making the offeror’s obligations under rule 33 of the Code subject to registration of the transfer by a third party - the target company’s directors.

The view has been expressed that the Panel’s approach may mean that any offeror would be required to waive the requirement of registration and pay accepting shareholders by the end of the 7-day period even if registration of particular transfers is denied. The Panel considers that it is a matter for the offeror to formulate in the offer protections against the failure of the target company to register the share transfers so that the offer can be made unconditional and the consideration paid in compliance with the requirements of the Code. This does not of course require payment where the seller itself is in breach of any of the terms of the contract formed by acceptance of the offer e.g. by not providing the documentation required by the contract or where the existence of the charge means that the seller is not delivering unencumbered title to the shares.

PRACTICE NOTE - TAKEOVER OFFERS - RULE 25(1) & CLAUSE 9 OF SCHEDULE 1 OF THE CODE

Rule 25(1) of the Takeovers Code provides that a takeover offer may be subject to conditions, except conditions that depend upon the judgement of the offeror or any associate of the offeror or conditions where fulfillment is in the power or under the control of the offeror or any associate of the offeror.

The Panel has been asked to clarify whether or not a condition that a takeover offer is subject to:

- approval of the shareholders of the offeror under section 129 of the Companies Act 1993; or
 - the provision of finance or financial support by a third party
- is permissible under rule 25(1) of the Code. In relation to finance conditions there is also the related issue of the requirements of clause 9 of the First Schedule to the Code.

Shareholder approval

Whether or not a condition that a takeover offer is subject to shareholder approval under section 129 of the Companies Act is permissible under rule 25(1) turns on whether or not the approval of shareholders is a matter which is “in the power or under the control” of the offeror or any associate of the offeror.

Although in the case of a major transaction it is the shareholders of the offeror who will vote on the relevant resolution it is difficult to separate the offeror company from its shareholders. The directors have to call the shareholder meeting and advise the shareholders of the merits of the proposal. They also have a duty to act in good faith and to act in the best interests of the company i.e. the offeror. If an adverse event were to occur that resulted in the takeover no longer being in the best interests of the offeror, the directors could well be obliged to recommend that shareholders do not approve the takeover offer and it would lapse.

The intention of rule 25(1) is to promote certainty in takeover offers, thus preventing an offeror from circumventing restrictions in the Code regarding the withdrawal of an offer. To allow offers to be made subject to shareholder approval could in effect allow an offeror to have an option over the shares of the target company. This would be inconsistent with the objectives of the Code. Accordingly, in the Panel’s view offers conditional on the approval of shareholders of the offeror would not comply with rule 25(1).

The effect of the Panel’s view is that shareholder approval will need to be obtained before the offer is sent to shareholders. This does not mean that approval need be obtained before the takeover notice is given. The period between the giving of the takeover notice and the last date by which an offer must be sent to shareholders provides some flexibility to the offeror in the timing of the meeting. However, where the takeover notice is given before shareholder approval is obtained, it should be made clear to the target company that the takeover offer cannot be dispatched if shareholder approval is not obtained by the time the offer is required to be sent. The takeover notice itself is required to be the same as the offer document and cannot include a condition related to shareholder approval.

Third party finance

Where an offer is conditional on the provision of finance or financial support from a third party, whether or not the condition is permissible under rule 25(1) turns on whether the condition is “in the power or under the control” of the offeror or any associate of the offeror.

Firm financing arrangements would need to be in place at the time the offer is made with the ability to terminate the arrangements being with the third party and not the offeror. The conditions in the financing arrangements that allow termination by the third party are of critical importance. If the conditions are limited to conditions that are bona fide required to protect the third party and cannot be used as a device to avoid the takeover offer, then the finance condition in the offer should be permissible under rule 25(1). However, the facts of each case must be considered in terms of the requirements of rule 25(1).

Clause 9 of the First Schedule

Clause 9 of the First Schedule to the Code provides that the takeover offer must contain confirmation by the offeror that resources will be available to the offeror sufficient to meet the consideration to be provided on full acceptance of the offer and to pay any debts incurred in connection with the offer (including debts arising under rule 49).

Here again with an offer conditional on finance, the question of whether clause 9 will be satisfied depends on the terms and conditions of the financing arrangements. In the Panel’s view the important words in clause 9 are that “resources *will be* available to the offeror”. Hence the grounds upon which the financial arrangements would be withdrawn would need to be very limited so that the offeror can be confident that the finance will in fact be available.

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