

**AN EXTENSION TO CLAUSE 25 OF THE TAKEOVERS CODE
(CLASS EXEMPTIONS) NOTICE (NO 2) 2001**

**A CONSULTATION PAPER ISSUED BY THE
TAKEOVERS PANEL**

August 2014



TAKEOVERS PANEL

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Introduction

1. The Panel is considering whether to grant a class exemption for transfers of Code company voting securities between bodies corporate or between a body corporate and a natural person, where the bodies corporate are, or the body corporate is, wholly-owned and controlled by the same natural person.¹ This may be as an extension to the current class exemption that enables such transfers where the controller is a body corporate.
2. Clause 25 of the Takeovers Code (Class Exemptions) Notice (No 2) 2001 (“Class Exemptions”) exempts transfers of Code company voting securities between members of a wholly-owned group of bodies corporate. Over the past few years, the Panel has received enquiries about, and approved the granting of exemptions in relation to, entities that were wholly-owned and controlled by the same persons (where at least one person was not a body corporate) and that wished to transfer voting securities in Code companies between themselves. Clause 25 of the Class Exemptions does not cover this situation.
3. This paper discusses the Panel’s current approach to these enquiries and applications and considers the appropriateness of granting a class exemption.

Request for comments on this paper

4. The Panel invites submissions on the issues raised in this paper and the options identified for addressing the issues.
5. The closing date for submissions is **Friday, 12 September 2014**.
6. Submissions should be sent for the attention of Lauren Donnellan to:

By email lauren.donnellan@takeovers.govt.nz

By post Takeovers Panel
Level 3, Solnet House
70 The Terrace
P O Box 1171
WELLINGTON 6011

Official Information Act

7. 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.

¹ Throughout this document, and unless otherwise indicated, “natural person” includes:

- (a) a natural person;
- (b) two or more natural persons holding and controlling jointly;
- (c) two or more natural persons and legal persons holding and controlling jointly.

Identification of the Problem - description of the status quo

8. Rule 6 of the Code, the fundamental rule, prohibits a person from becoming the holder or controller of an increased percentage of the voting rights in a Code company, unless, after that event, that person and that person's associates hold or control in total not more than 20% of the voting rights in the Code company.²
9. Accordingly, unless they have an exemption from the Code, a person (whether legal or natural) may breach the Code if, together with an associate, the person holds or controls 20% or more of the voting securities in a Code company and the person and the associate transfer the holdings of voting securities between themselves. This is because the transferee, together with its associate (i.e., the transferor) holds or controls more than 20% of the voting rights in a Code company. The breach would occur even though there may be no change in the ultimate control of the voting rights where, for example, the two persons are each wholly-owned subsidiaries of a parent company or wholly-owned companies of a natural person.
10. Rule 7 of the Code provides the mechanisms by which a person may increase their holding or control of Code company voting rights without breaching the rule 6 prohibition. For example, under rule 7(c) a person may become the holder or controller of an increased percentage of the voting rights in a Code company if the acquisition has been approved by an ordinary resolution of the Code company. The Code company would need to hold a shareholders meeting and engage an independent adviser approved by the Takeovers Panel to prepare a report for the shareholders on the merits of the acquisition. The person cannot undertake the acquisition until the shareholders have passed the resolution.
11. Clause 25 of the Class Exemptions exempts transfers of voting securities between members of a wholly-owned group of companies or other bodies corporate:

“Exemption for transfers within wholly-owned groups

- (1) *Every person who is a member of a group is exempted from rule 6(1) of the Code in respect of any increase in the person's voting control.*
- (2) *The exemption is subject to the condition that—*
 - (a) *the person's increase in voting control results from a transfer of voting securities in—*

²Rule 4 of the Code defines ‘associates’ for the purposes of the Code. A person is an associate of another person if:

- (a) the persons are acting jointly or in concert; or
- (b) the first person acts, or is accustomed to act, in accordance with the wishes of the other person; or
- (c) the persons are related companies; or
- (d) the persons have a business relationship, personal relationship, or an ownership relationship such that they should, under the circumstances, be regarded as associates; or
- (e) the first person is an associate of a third person who is an associate of the other person (in both cases under any of paragraphs (a) to (d)) and the nature of the relationships between the first person, the third person, and the other person (or any of them) is such that, under the circumstances, the first person should be regarded as an associate of the other person.

(i) *a code company from a member of the group to another member of the group; or*

(ii) *a member of the group, other than the group parent, from a member of the group to another member of the group; and*

(b) *the group parent has control of the voting securities in the code company before and after the transfer.”*

12. The statement of reasons for the Class Exemptions states that clause 25 is appropriate as it facilitates normal intra-group transactions and is consistent with the objectives of the Code because the attaching conditions ensure that there is no change in the ultimate control of the voting rights in the Code company.

13. However, the class exemption does not cover the situation where the ultimate controller of the Code company shares to be transferred is a natural person, or is a natural person together with a body corporate as joint owners. Under the definition for the Class Exemptions:

(a) “group” means a *body corporate* and its wholly-owned subsidiaries; and

(b) “group parent” means a *body corporate* that is a member of a group and is not a wholly-owned subsidiary of another body corporate.

14. The Panel treats the term “group” as including circumstances where there is only one subsidiary.³

15. Accordingly, if a transfer occurs:

(a) from a body corporate in a “group” to a natural person⁴ who controls the “group”; or

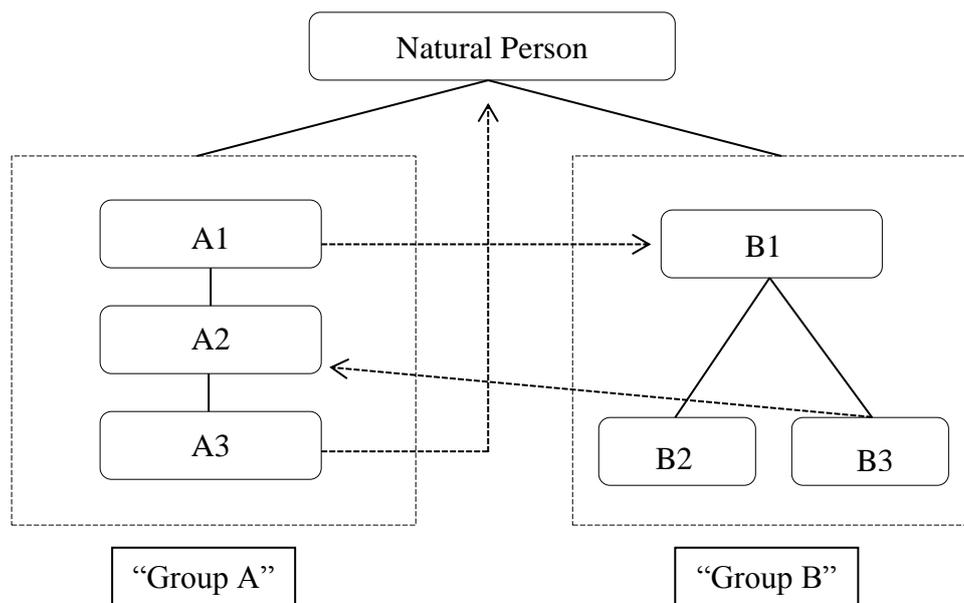
(b) in the case of two bodies corporate in different “groups” controlled by the same natural person, from one body corporate to the other body corporate;

the transfer is not exempt from the Code under clause 25 of the Class Exemptions and may breach rule 6(1) of the Code without a specific exemption being granted or shareholder approval being obtained.

16. The diagram below shows examples of transfers of Code company voting securities that are not currently exempted by clause 25 of the Class Exemptions:

³ See the circumstances of the Takeovers Code (Veritas Investments Limited) Exemption Notice (No 2) 2013 (described at paragraphs 22 – 27 of this paper) and section 3 of the Interpretation Act 1999.

⁴ See footnote 1 for definition of “natural person”.



18. The Panel’s approach has been to review transactions that involve transfers within groups of companies or other bodies corporate that are owned and controlled by natural persons on a case by case basis. The Panel will grant individual exemptions where it is satisfied the exemption is appropriate. The Panel is considering whether this approach remains optimal or whether a class exemption for such transactions should be granted by the Panel.
19. The Panel from time to time receives enquiries from legal advisers whose clients wish to reorganise their investment holding structure by transferring Code company voting securities between entities that are wholly-owned and controlled by the same natural person. When their clients understand that they would need an exemption in order to complete the transfer, they can be put off by the cost and time involved in obtaining that exemption.
20. However, on occasion, for example when the proposed transfer is part of a bigger transaction, an application for an exemption is made. The Panel’s time is charged at an hourly rate so the cost of an exemption varies depending on its complexity.⁵

Examples of exemptions

21. Although the Panel executive has responded to a number of enquiries regarding the issues discussed by this paper, only two such exemption applications have been received and exemptions approved by the Panel. Those two exemptions are described below.

⁵ See regulation 4 of the Takeovers (Fees) Regulations 2001. The Panel’s fees for a straightforward application may amount to around \$4,000 - \$5,000. A more complex application may cost more in the order of \$10,000 to \$15,000. In addition to the Panel’s fees applicants will also have legal fees to pay.

Takeovers Code (Veritas Investments Limited) Exemption Notice (No 2) 2013

22. The Panel granted an exemption from rule 6(1) of the Code to the trustees of the Michael Morton No. 2 Family Trust. At that time Michael John Morton and WBM Trustee Limited were the trustees. The exemption was for any increase in the trustees' holding of voting securities in Veritas Investments Limited ("VIL") (a Code company) that resulted from a transfer of VIL voting securities from Wilmat Holdings Limited ("Wilmat") to the trustees.
23. In 2012, VIL completed an acquisition from MBH Limited (previously known as Mad Butcher Holdings Limited) ("MBH") of the Mad Butcher business. As part of the consideration for the purchase of the Mad Butcher business, VIL allotted ordinary shares to MBH. MBH ended up holding and controlling more than 20% of VIL.
24. MBH was a wholly-owned subsidiary of Wilmat, which itself was wholly-owned by the trustees.
25. Wilmat proposed to liquidate MBH following the expiry of the warranty claims period under the sale and purchase agreement between VIL and MBH and to transfer MBH's VIL shares to Wilmat. The transfer from MBH to Wilmat took place in reliance on clause 25 of the Class Exemptions.
26. The trustees then proposed to liquidate Wilmat and to distribute the VIL shares held by Wilmat to the trustees. This transfer was not able to take place in reliance on clause 25 of the Class Exemptions because one of the trustees, Michael Morton, was a natural person. In the absence of an exemption this transfer would have required shareholder approval or would have breached rule 6(1) of the Code.
27. The Panel granted an exemption for the transfer of VIL voting securities from Wilmat to the trustees. The Panel considered that the exemption was appropriate and consistent with the objectives of the Code because:
 - (a) there was no change in the ultimate control of the voting rights in VIL (unless there was a change in the trustees) ⁶ because ultimate control of VIL would remain with the trustees before and after the transfer; and
 - (b) the exemption avoided unnecessary compliance costs that would be incurred if it were not granted.

Takeovers Code (TRS Investments Limited) Exemption Notice 2014

28. The Panel granted retrospective exemptions from rule 6(1) of the Code for Beconwood Superannuation Pty Limited in respect of multiple transfers of shares in TRS Investments Limited ("TRS") (a Code company) from Beconwood Securities Pty Limited. As a result of the transfers, Beconwood Superannuation increased its holding and control of voting rights in TRS to 37.11%.

⁶ The Takeovers Code (Veritas Investments Limited) Exemption Notice (No 2) 2013 also contains exemptions for future changes of trustees.

29. Both Beconwood entities were Australian registered companies and were wholly-owned and controlled by Mr Paul Choiselat and Mrs Lynette Choiselat (the “Choiselats”). Mr Choiselat was a director of both companies. Mrs Choiselat and John Choiselat (their son) were directors of Beconwood Superannuation.
30. Had the Choiselats held their interest in the Beconwood entities in a holding company, the transactions would have been covered by clause 25 of the Class Exemptions. Because the Choiselats held their interest as natural persons, clause 25 of the Class Exemptions did not apply, and, as Beconwood Superannuation, together with its associate Beconwood Securities, held or controlled more than 20% of the voting rights in TRS, the transfers breached rule 6(1) of the Code.
31. The Panel considered that it was appropriate and consistent with the objectives of the Code to grant the exemptions because:
 - (a) although the share transfers resulted in a change in the holding of voting rights in TRS, there was no change in the control of voting rights in TRS as a result of the transfers;
 - (b) shareholders of TRS were not disadvantaged by not having the opportunity to vote on the transfers at a meeting of shareholders as the transfers had no real effect on those shareholders; and
 - (c) any breach of the Code appeared to be inadvertent.

The position in Australia

32. Chapter 6 of the Australian Corporations Act 2001 does not prevent transfers between bodies corporate owned or controlled by common persons.
33. The focus in Australia is on “relevant interests” in shares of a body corporate regulated by Chapter 6 of the Corporations Act, and related bodies corporate under common control are deemed to have the same relevant interests as each other.

Problem Identification – Conclusion

34. Clause 25 of the Class Exemptions exempts transfers of voting securities between members of a wholly-owned group of bodies corporate. However, the class exemption does not exempt such transfers where the “group parent” is a natural person. There is no apparent reason for the class exemption to exclude natural persons.
35. Although this problem can be overcome through the Panel’s power to grant individual exemptions on a case by case basis, the preparation of an application for an exemption can involve significant time and expense for the applicant. Anecdotal evidence indicates that such transfers, which could be beneficial to the persons involved, often are not undertaken due to these costs. The magnitude of the problem does not appear to be great on a whole-of-jurisdiction level. However, for the individuals impacted, the cost might be thought to be high. Also, the need to apply for an individual exemption from the Code on a case by case basis creates a level of uncertainty for the applicant.

Policy Objectives

36. The Panel's policy objectives are to:
- (a) reduce compliance costs where appropriate;
 - (b) ensure consistency with the objectives of the Code; and
 - (c) maintain a proper relationship between the costs and benefits of compliance with the Code.

Questions

- 1. Do you agree that the Panel has identified the problem correctly? If not, how would you describe the problem?**
- 2. Do you agree with the Panel's policy objectives? If not, what policy objectives would you suggest instead?**

Options

37. The options considered by the Panel are:
- (a) maintain the status quo, whereby transfers of Code company voting securities:
 - (i) from a body corporate in a "group" to a natural person⁷ who controls the "group"; or
 - (b) in the case of two bodies corporate in different "groups" controlled by the same natural person, from one body corporate to the other body corporate;must comply with the Code, or be undertaken under an individual exemption granted by the Panel on a case by case basis; or
 - (b) grant a class exemption from rule 6(1) of the Code to exempt these transfers of Code company voting securities.

Option 1 – Maintain the Status Quo

Key features of Option 1

38. Under this option, the Panel would continue to consider applications for exemptions for transfers of Code company voting securities from a body corporate in the "group" to a natural person who controls the "group", or in the case of two bodies corporate in different "groups" controlled by the same natural person, from one body corporate to the other body corporate.

⁷ See footnote 1 for the definition of "natural person".

Analysis of Option 1

39. Option 1 partially meets the policy objective of maintaining a proper relationship between the costs and benefits of compliance with the Code and fully meets the objective of ensuring consistency with the objectives of the Code.
40. If the Panel accepts that there is no change of control in such transfers, and that the Code should not apply to such transfers, then it is likely that the Panel will grant an individual exemption and the cost of holding a shareholder meeting to approve the transfer (including the cost of commissioning an independent adviser's report) can be avoided. However, the Panel acknowledges that there is a cost, both in terms of Panel fees and an applicant's legal fees, in seeking an individual exemption, and a level of uncertainty about whether an individual exemption will be granted.
41. Accordingly, option 1 does not fully meet the policy objectives.

Option 2 – Grant a new class exemption or amend clause 25 of the Class Exemptions – preferred option

Key features of Option 2

42. Under this option, the Panel would grant a class exemption from rule 6(1) of the Code for transfers of Code company voting securities from a body corporate in a “group” to a natural person who controls the “group”, or in the case of two bodies corporate controlled by the same natural person, from one body corporate to the other body corporate.
43. The exemption would be subject to substantially similar conditions as the exemption in clause 25 of the Class Exemptions, that:
 - (a) the natural person's increase in voting control results from a transfer of voting securities in:
 - (i) a Code company, from a member of the “group” to another member of the “group” or to a member of another “group”;⁸ or
 - (ii) a member of the “group”, from a member of the group to to another member of the “group” or to a member of another “group”; and
 - (b) the natural person parent of the “group” or both “groups” has control of the voting securities in the Code company before and after the transfer.

Analysis of Option 2

44. Option 2 would alleviate the current cost/efficiency burden associated with individual exemptions and would also provide certainty for natural persons wishing to transfer

⁸ The “group” in this context would be the natural person and bodies corporate wholly-owned and controlled by the same natural person. See footnote 1 for the definition of “natural person”.

Code company voting securities between their investment vehicles, or from their investment vehicles to themselves.

45. Because the class exemption would be freely available to any natural person whose investment holdings were within the terms and conditions of the exemption, it meets very well the policy objectives of reducing compliance costs and ensuring consistency with the Code. Since there is no change of controller of the Code company voting rights, only a change to the holder, there is no impact on the other Code company shareholders. Therefore, the policy objective of maintaining a proper relationship between the costs and benefits of compliance with the Code is also met by option 2.
46. The Panel would no longer have oversight of such transactions; however, this should not be of concern as the proposed conditions of exemption would ensure that only transfers where no change of control has occurred would be exempted from compliance with the Code.
47. For these reasons option 2 is the Panel's preferred option.

Questions

3. Do you agree with the Panel's preferred option? If not, why not?

4. Do you agree with the proposed conditions of the class exemption? If not, can you suggest other conditions that would be appropriate along with your reasons for suggesting the other conditions?

5. Do you think that there is any risk of an inappropriate reliance on the proposed exemption? If so, can you suggest ways that this might be mitigated?