PARTIAL OFFERS

A CONSULTATION PAPER ISSUED BY THE TAKEOVERS PANEL

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28 August 2009

INTRODUCTION

1. The Panel has reviewed the provisions of the Code that relate to partial takeovers.

2. The Panel has noted that it has had to intervene in most of the partial offers that have been made under the Code, whether directly by way of enforcement action or the granting of exemptions, or indirectly through informal measures (such as suggesting revisions to draft offer documents).

3. The Panel is concerned about any difficulties that market participants are experiencing with the provisions of the Code which relate to partial offers.

Request for comments on this paper

4. The Panel invites submissions on the preferred options in this paper.

5. The closing date for submissions is **5p.m. Friday, 9 October 2009**.

6. Submissions should be sent to the Takeovers Panel:

   - By email - takeovers.panel@takeovers.govt.nz
   - By post - Takeovers Panel
Level 3, Solnet House
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WELLINGTON; or
   - By fax - +64 4 815 8459.

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.

EXECUTIVE SUMMARY

8. A partial offer under the Code enables a person to become the holder or controller of 20% or more, but less than 100%, of the voting rights in a Code company,[1] by way of an offer to all shareholders.

9. Partial takeovers occur relatively infrequently in the New Zealand market, comprising about 10% of all offers made under the Code. Eleven partial offers have been made since the introduction of the Code in 2001. In contrast, (at the time of writing) 90 full offers have been undertaken.

10. A partial offer is subject to some rules in the Code which specifically relate to the nature of partial offers, but in all other respects is subject to the same rules as a full offer.

11. The Panel has reviewed the provisions of the Code that relate to partial offers and has identified the following issues:

    (a) The potential distortion in the scaling of acceptances where shares in the target company are held by a custodian or nominee;

    (b) Frequent misstatements in draft offer documentation of the "specified percentage" of shares being sought by the offeror under a partial offer;

    (c) Problems with identifying the persons eligible to vote on whether to approve an offeror making a partial offer that results in the offeror having voting control in the target company of 50% or less;

    (d) Potential difficulties caused by the percentage of voting rights already held or controlled by an offeror being diluted during the course of an offer;

    (e) Potential difficulties for an offeror that wishes to extend the offer period of a partial offer; and

    (f) The implication of votes cast by the offeror or its associates to approve an offeror making a partial offer that results in the offeror having voting control in the target company of 50% or less.

12. The Panel's objective is to ensure that partial offers are an effective and efficient mechanism for facilitating changes of control of Code companies.

13. In light of the issues identified, the Panel proposes a number of options for resolving the issues. The options are analysed against the Panel's objective. Some of the

[1] 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 of 12 months before a date or the occurrence of an event referred to in this Code; or
(c) has 50 or more shareholders.

proposed preferred options are for the Panel to recommend to the Minister of Commerce amendments to certain rules in the Code.

14. Appendix A of the paper is a hypothetical example of a partial offer by an offeror who wishes to increase its voting control in a Code company to 50.1%. It compares the outcome of the application of the scaling rules between a share register of direct shareholders in the target company and a share register where at least one major shareholder is a nominee, holding on behalf of several underlying beneficial owners.

15. Appendix B is a review of the partial offers made under the Code, based on the information available in the Panel's records.

STATUS QUO

Status quo

16. The fundamental rule contained in rule 6(1) of the Code is that no person can:

    (a) increase their control percentage to more than 20% (together with their associates) of the voting rights in a Code company; or

    (b) increase an existing percentage of 20% or more of the voting rights in a Code company.

17. Rule 7 of the Code provides for various exceptions to the fundamental rule. One of those exceptions, under rule 7(b), is an acquisition of voting rights through a partial offer.

18. Rules 9 to 14 in Part 3 of the Code prescribe specific requirements in respect of partial offers. Parts 4 to 6 of the Code set out the various general rules in respect of both full and partial takeover offers. Part 4 provides general provisions that apply to an offer, such as the requirement that the same price is offered to all shareholders, an independent adviser's report on the merits of the offer is prepared, and rules in respect of the conditions of the offer, making variations to the offer, and payment of the consideration. Part 5 relates to dealings and defensive tactics by the target company during the course of the offer. Part 6 relates to the offer procedure.

19. A partial offer is an offer for a "specified percentage" of the voting securities in the target company, which are not already held or controlled by the offeror (rule 9).[2]

Figure 1: Specified percentage example

AB holds or controls 19.99% of the voting rights in XYZ Limited, a Code company. AB wishes to increase its shareholding in XYZ Ltd to 50.1% by way of a partial offer in accordance with the Code.

AB's successful partial offer would result in it acquiring a further 30.11% of the **total** voting rights in XYZ Ltd. XYZ Ltd has 100,000,000 voting securities on issue. Accordingly, under the offer, AB would acquire a further 30,110,000 XYZ Ltd voting securities.

The partial offer must be made for a "specified percentage" of voting securities in XYZ **not already held or controlled** by AB. The specified percentage is calculated as follows:

$$\frac{\text{Percentage of total voting rights sought by AB (30.11\%)}}{\text{Percentage of total voting rights not already held or controlled by AB (80.01\%)}} \times 100 = \text{The specified percentage (37.63\%) (rounded)}$$

Accordingly, AB's offer will be for a specified percentage of **37.63%** of the voting rights held or controlled by each of the XYZ Ltd shareholders other than AB. 37.63% of the 80,100,000 voting securities in XYZ not already held or controlled by AB is 30,110,000 (rounded), which is the total

[2] If there is more than one class of voting security, the offer must be made for a specified percentage of each class not already held or controlled by the offeror. The percentage in each class must be the same and the offer must be certified as being fair and reasonable as between the classes by an independent expert (Rules 9(4) and (5)).

number of voting securities sought by AB under its offer.

20. An offeree may accept a partial offer in respect of any number of their shares.

21. If the offer is successful, the offeror must take up (and, consequently, the offeree will sell) the lesser of either:

    (a) The number of the offeree's securities that equates to the specified percentage; or

    (b) The number of securities that the offeree accepts into the offer.[3]

22. To the extent that the offeror does not receive, under the above formula, sufficient acceptances to acquire the specified percentage of voting securities sought under the offer, the offeror must acquire the further securities that it requires to reach its desired amount from offerees with "excess" acceptances. Offerees with excess acceptances are those offerees who have accepted the offer in respect of more of their securities than the specified percentage. The offeror takes up the required number of securities from the 'pool' of excess acceptances on a pro rata basis from the relevant offerees.[4]

Figure 2: Example scaling of excess acceptances

AB makes its partial offer for 30,110,000 securities, being 37.63% of the voting rights in XYZ Limited that it does not already hold or control (see Figure 1 above).

Some XYZ shareholders accept the offer in respect of more of their voting securities than the specified percentage, some equal to, some less, and some not at all. AB needs to receive a minimum of 30,110,000 securities, being the number equating to the specified percentage. In total, AB receives acceptances in respect of 40,000,000 voting securities in XYZ.

The acceptances must be scaled as follows:

First stage: AB must take up from each offeree (who accepted the offer) **the lesser of 37.63%** of their securities **or the actual number** of securities that they accepted into the offer.

Under the first stage, AB takes up, say, acceptances in respect of 25,000,000 securities.

AB, therefore, requires a further 5,110,000 securities. Given the total acceptances of 40,000,000 securities (and AB taking up 25,000,000 under the First Stage), there is a surplus 'pool' of 15,000,000 securities remaining, from which AB will take up its further required securities.

Second stage: AB must take up 5,110,000 securities from those acceptors who have accepted the offer in respect of **more than 37.63%** of their shares (the offerees with "excess" acceptances). This is done on a **pro rata** basis, as follows:

$$\frac{\textit{Number of further securities required (5,110,000)}}{\textit{Number of surplus acceptances (15,000,000)}} \times 100 = 34.06\% \text{ (rounded)}$$

Accordingly, under the second stage, AB would take up **34.06%** of the "excess" acceptances from each offeree who accepted the offer in respect of more than 37.63%

[3] Rule 12(1).
[4] Rule 12(2) and (3). Rule 13 deals with the scaling of excess acceptances where there is more than one class of voting securities under offer.

of their shares.

For example, Matt holds 10,000 XYZ voting securities. Matt accepts AB's offer in respect of all his securities. Under the First Stage, AB will take up 3,763 of Matt's securities (which represents the specified percentage) and leave Matt with a balance of 6,237 securities (which are Matt's "excess" acceptances). Under the Second Stage, AB will take up 34.06% of Matt's remaining 6,237 securities, which is 2,124. In total, Matt sells 5,887 of his 10,000 XYZ Ltd securities into AB's offer (rounded).

23. A hypothetical example of a partial offer is set out in Appendix **A**. Although the hypothetical applies some different assumptions to Figure 2 above, it includes another example of the scaling provisions.

24. The effect of the pro rata scaling provisions is that offerees who send in "excess" acceptances will have a greater proportion of their securities taken up by the offeror than offerees who only accept the offer in respect of the specified percentage of their securities or less. The scaling provisions would not be triggered if every single offeree accepts the offer and all of them accept in respect of exactly the specified percentage of their securities sought by the offeror.

25. Rule 14 provides that the number of securities that an offeree can sell into an offer is determined by the number of securities held by that offeree at the end of the offer period (as recorded in the securities register of the target company). Rule 14 is designed to prevent an offeree from "multiplying" their total acceptances by accepting an offer in respect of the specified percentage of their securities, and then, before the end of the offer period, transferring the balance of their holding to a related party, who then accepts the offer in respect of the specified percentage of the balance.[5]

26. The Code also imposes mandatory conditions on a partial offer:

    (a) If a successful offer would result in the offeror holding *50% or less* of the total voting rights in the target company, the offer must be subject to the following conditions:

        i. The offer is approved by the offerees in accordance with rule 10(1)(b) of the Code; and

        ii. The offeror receives sufficient acceptances which would, together with any voting securities already held or controlled by the offeror, confer on it the percentage of voting securities approved by the offerees under rule 10(1)(b)[6];

        or

    (b) If the offer is for *greater than 50%* of the voting rights in the target company, the offer must be conditional on the offeror receiving a minimum percentage of acceptances which would, together with any voting securities already held

[5] In the absence of rule 14, such an arrangement would be permitted by virtue of rule 43, which provides that an offer may be made to persons who acquire securities in the target company after the record date.
[6] Rule 23(1).

or controlled by the offeror, confer on the offeror more than 50% of the voting rights in the target company.[7]

27. In relation to these conditions, the Panel decided in the *GPG Forests/ Rubicon* Determination that the "or" between (a) and (b) above definitely means "or", and not "and":[8]

> *[A] potential offeror must choose between whether to make an offer for a specified percentage of the target company's shares that would take its total control of voting rights to more than 50%, or choose a specified percentage that would take its voting control to 50% or less. In the latter case, the offer needs the approval of the majority of non-associated shareholders who choose to vote.*

28. The Determination related to a proposed partial offer which was expressed in "alternatives" – the offer was for either, a specified percentage of the target company's voting securities that would, if successful, result in the offeror holding or controlling greater than 50% of the total voting rights; or, if insufficient acceptances were received under that offer, an alternative offer for an unspecified lesser percentage in a range of between 30% to 50% of the voting rights not already held or controlled by the offeror. The alternative offer was subject to the condition that the target company shareholders approved the offeror taking up an unspecified percentage of voting securities within the 30%-50% range. The Panel considered that the proposal breached the Code.[9]

Comparison with Australia

29. Australia's takeovers regulations (Chapter 6 of the Corporations Act 2001) provide for a regime for "proportional" takeovers.

30. Under section 618 of the Corporations Act, a bidder may make an offer for a specified proportion of the securities in a 'bid class' (the class of the target company's securities to which the bid relates). The specified proportion must be the same for all holders of securities in the bid class.[10]

31. The bidder cannot scale the acceptances it receives from the target company shareholders. Therefore, for a bidder to obtain the specified proportion of the target company's shares, the bidder must receive acceptances in respect of the specified proportion from every one of the target company's shareholders. In order to achieve a desired shareholding (for example, 50.1%), the bidder would need to make an offer for a higher proportion of each shareholder's shares, so as to account for the possibility that some shareholders might not accept the offer.[11]

32. A proportional bid is not automatically subject to a requirement that the bid be approved by the target company shareholders (as is the case in New Zealand for partial offers which would result in the offeror having voting control of 50% or less).

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[7] Rule 23(1)(a).
[8] (6 September 2002) http://www.takeovers.govt.nz/decisions/2002/determination_gpg_rubicon.htm para 27.
[9] In 2007, rule 10 of the Code was amended to clarify within the Code itself the requirement for the offeror to makes its partial offer for one only of the types of partial offer described in paragraph 17 above.
[10] Corporations Act, s 618(1)(b)
[11] Ramsey, Ian "Balancing Law and Economics: The Case of Partial Takeovers" *Journal of Business Law* (July 1992), pp 369-397, 372.

An Australian company may include proportional takeover approval provisions in its constitution. If it does, the company is prohibited from registering a transfer of securities as a result of a proportional bid unless the target company shareholders pass a resolution approving the bid.[12]

33. Acceptances into a proportional bid are subject to a "look though" provision where securities in the target company are held by a trustee or nominee. Section 653B of the Corporations Act provides that a person who is a beneficial owner of securities which are held by a nominee is treated as if that person held the securities directly in the target company.

34. The Australian partial offer regime was changed in 1986. Previously, a bidder could make a "pro rata" bid whereby the bidder offered to acquire a specified percentage of the shares in the target company. If acceptances were received which exceeded the specified percentage sought under the offer, the bidder would take up a pro rata proportion of each accepting shareholder's shares. There was no facility for the target company shareholders to approve or object to the "pro rata" bid.[13]

35. The reforms in 1986 were introduced because of a concern that "pro rata" partial takeovers coerced target company shareholders into accepting the offer even if the shareholders did not believe the offer to be fair. The reform has resulted in a significant reduction in the number of partial offers made in Australia. [14]

[12] Corporations Act, s 648D(1).
[13] *Ford's Principles of Corporation Law* (www.lexisnexis.com) paragraph 23.350 "Takeover offers".
[14] Ramsey, Ian "Balancing Law and Economics: The Case of Partial Takeovers", page 370.

PROBLEM IDENTIFICATION

36. The Panel has identified the followings issues in relation to partial offers:

    (a) The potential distortion in the scaling of acceptances where shares in the target company are held by a custodian or nominee;

    (b) Frequent misstatements in draft offer documentation of the "specified percentage" of shares being sought by the offeror under a partial offer;

    (c) Problems with identifying the persons eligible to vote on whether to approve an offeror making a partial offer that results in the offeror having voting control in the target company of 50% or less;

    (d) Potential difficulties caused by the percentage of voting rights already held or controlled by an offeror being diluted during the course of an offer;

    (e) Potential difficulties for an offeror that wishes to extend the offer period of a partial offer; and

    (f) The implication of votes cast by the offeror or its associates to approve an offeror making a partial offer that results in the offeror having voting control in the target company of 50% or less.

37. The Panel seeks the views of practitioners and market participants on these issues. Do you agree or disagree that the issues are problematic? Why do you agree/disagree? The Panel would also appreciate comments on whether there are other problems that have been experienced with the Code's rules on partial offers.

38. The issues are set out in detail below.

Case studies

39. Appendix **B** to this paper contains a description of each of the partial offers made under the Code to date and any Code-compliance issues that were raised which were specifically related to the nature of partial offers.

Issue 1: Treatment of nominee and custodial holdings for scaling purposes

40. It is a common arrangement in New Zealand for securities in listed companies to be held by nominees or custodians on behalf of the beneficial owner of the securities. The nominee or custodian is the registered holder of the securities, while the underlying beneficial owner enjoys the economic interest in the securities.

41. A nominee or custodian might hold voting securities on behalf of many different beneficial owners. For example, New Zealand Central Securities Depository Limited ("NZCSD") holds securities in listed companies as a custodian on behalf of the participants in the Austraclear New Zealand settlement and clearance system.[15]

42. If the partial offer is accepted in respect of more securities than those sought by the offeror, the scaling provisions in rules 12 and 13 of the Code determine the number of voting securities that the offeror must take up from those offerees who have accepted the offer in respect of greater than the specified percentage.

43. The scaling calculation can result in significant distortions if the acceptances of the underlying beneficial owners of securities are aggregated at the registered-holder level (i.e., by the nominee or custodian), as opposed to the underlying owners' acceptances being scaled *as if* the owners were the registered holders of the securities. If any of the underlying owners accept the offer in respect of *less than* the specified percentage of their securities, any other underlying owners who accept in respect of *more than* the specified percentage will have a greater proportion of their securities taken up by the offeror than if those underlying owners had held the securities directly on the register.

44. The distortion is demonstrated in the hypothetical partial offer example **attached** in Appendix **A**. The example shows that one shareholder ("C", in the example) has all (100%) of its securities taken up as a result of the hypothetical offer for 37.63% of its securities, by virtue of the distortion caused by C's securities being held by a nominee, together with the securities of other shareholders, one of whom does not accept the partial offer at all.

45. The distortion would not occur if the offeror was permitted to "look through" the holding of a nominee or custodian and treat, for scaling purposes, the acceptances of the underlying owners *as if* those owners were registered shareholders.

46. Rules 12 and 13 refer to the offeror taking up, in accordance with the scaling formula, acceptances from "the offeree". The rules beg the question as to who is an "offeree" and whether it refers to the nominee/custodian on the Register or the underlying owner of the securities. A look through does not, however, appear to be possible under a literal interpretation of rule 12 of the Code. Rule 43(1) of the Code provides that the "*offerees in respect of an offer are the persons shown as the holders of securities in the target company to which the offer relates on the securities register of the target company as at the record date.*" If rules 12 and 13 are read in light of rule

[15] NZCSD is owned by the Reserve Bank of New Zealand. The Austraclear participants are, typically, large financial institutions, which, themselves, act as nominees for the beneficial owners of the shares, many of whom are overseas residents. NZCSD holds a substantial inventory of securities in New Zealand listed companies (the inventory stood at around NZ$100 billion as at August 2008): Reserve Bank of New Zealand, *Overview of the Austraclear New Zealand System* (August 2008) http://www.rbnz.govt.nz/payment/austraclear/

43(1), the "offeree" for scaling purposes would be the nominee/custodian, not the underlying owner of the securities.

47. If a nominee or custodian is considered to be "the offeree", then rules 12 and 13 do not always produce an equitable scaling of the acceptances of a partial offer. A person whose securities are held by a nominee might have a greater proportion of their securities taken up than if that person held the securities directly in the target company.

48. The distortion issue was raised with the Panel for the first time by NZCSD in relation to the partial offer by Knott Partners LP and certain associated funds[16] (together, "Knott") for Rubicon Limited ("Rubicon") in April 2009.

49. Knott made a partial offer for a specified percentage of 10.83% of the voting securities in Rubicon that it did not already hold or control. NZCSD, as custodian of the Austraclear system, was the registered holder of approximately 85% of the voting securities in Rubicon. NZCSD noted that, as a result of the scaling provisions in the Code, acceptances by persons who are beneficiaries in a nominee arrangement may be scaled differently than if those persons held securities directly on the share register.

50. NZCSD proposed to address the distortion problem by splitting its holding into two "accounts": the first account would represent the securities of those beneficial owners who had accepted Knott's offer in respect of the specified percentage or less; and the second account would represent acceptances in respect of more than the specified percentage of the beneficiaries' securities.

51. NZCSD's proposal would, in effect, achieve a more equitable outcome. The beneficial owners would be treated *as if* they held securities directly in Rubicon.

52. From a legal perspective, NZCSD's proposal would have had to rely on a purposive interpretation to the word "offeree" in rule 12, so that scaling was applied on a "look through" basis. That is, the acceptance instructions of the underlying beneficial owners would be taken into account for the purposes of scaling, as though the underlying owner was the holder of the securities (i.e. was "the offeree": the person to whom the offer was made). In the end, NZCSD did not apply this approach, based on the view, it appears, of the offeror's New Zealand legal advisers that a literal interpretation of rules 12 and 13 was necessary (i.e. that, strictly speaking, NZCSD was the "offeree").

53. There is, therefore, potential uncertainty as to whether the literal application of rules 12 and 13 of the Code is appropriate. The Panel considers that this uncertainty is undesirable and wishes to consult with market participants on the most appropriate mechanism for addressing the issue.

[16] Knott Partners LP, Knott Partners Offshore Master Fund LP, Commonfund Hedged Equity Company, Good Steward Trading Company SPC, Muisanne Partners LP, Shoshone Partners LP, and Focus 300 Limited.

Issue 2: Misstatements of the specified percentage

54. A partial takeover offer under the Code must be made for a "specified" percentage of voting securities in the target company which are not already held or controlled by the offeror.[17]

55. The specified percentage must be correctly calculated because:

    (a) It is used to calculate the proportion of acceptances that the offeror must take up in accordance with rules 12 and 13 of the Code;

    (b) If the offeror will hold or control 50% or less of the target company as a result of the offer, the specified percentage will be referred to in the approval form sent to offerees for the purposes of voting on whether to approve of the offeror making the offer.[18] The specified percentage will also be referred to for the calculation of the relevant percentage for the minimum acceptance condition required by rule 23(1); and

    (c) The specified percentage may be referred to in public announcements made in relation to the offer. Any publication regarding the offer must avoid being misleading or deceptive.[19]

56. The Panel has noted six instances (out of a total of 11 partial offers made under the Code) where the specified percentage was misstated by the offeror.

57. In all cases, the misstatement was identified in the draft offer document that accompanied the offeror's notice of intention to make its offer. Therefore, any non-compliance was resolved prior to the offeror sending out the formal offer document to shareholders.

58. In the most recent cases, the Panel has developed a practice whereby the offeror is allowed to state the correct specified percentage in its offer document (rather than re-issuing a takeover notice and beginning the offer procedure again) if:

    (a) The target company directors consent to the offer document that is sent to shareholders being different from the draft offer document attached to the takeover notice, to the extent that the specified percentage is correctly stated in the offer document; and

    (b) Promptly after such consent being received, the offeror makes a market announcement explaining the error in the draft offer document that accompanied its notice of intention to make an offer.

59. The Panel had previously considered that, if there was a misstatement of the specified percentage, it meant that the draft offer documentation did not comply with the Code in a fundamental respect and had to be immediately withdrawn. The offer process

[17] See Figure 1 above for an example calculation of the specified percentage.
[18] Rule 10(1)(b).
[19] Rule 64 of the Code prohibits misleading or deceptive conduct and conduct that is likely to mislead or deceive.

would then be re-started with a new notice of intention that included a draft offer document that referred to the correct specified percentage.

60. If, under the approach referred to in paragraph 48, above, the directors of the target company did not consent to the change being made, an offeror would likely have to start the takeover process again. In a contested takeover, timing can be very important, so this can leave that offeror at a disadvantage while, correspondingly, the rival bidder may have an advantage. Moreover, in a hostile or contested takeover, any potential breach of the Code provides an opportunity for a party to complain to the Panel and to press for regulatory action against the alleged breaches. A misstatement of the specified percentage may, for example, be argued to be a breach of rule 9 (the rule requiring the offer to be for a specified percentage) or of clause 5 of Schedule 1 of the Code (which requires the offer document to set out all of the terms of the offer) and/or rule 64 of the Code (which prohibits misleading or deceptive conduct).

61. Given that misstatements appear to be a relatively regular occurrence, the Panel wishes to consult with market participants and practitioners on the best way to ensure that misstatements do not recur in the future.

Issue 3: Identity of the "offerees" for the purposes of voting under rule 10(1)(b)

62. If a successful offer would result in the offeror holding *50% or less* of the total voting rights in a target company, the offer must be conditional on (amongst other things) the offer being approved by the offerees in accordance with rule 10(1)(b) of the Code.

63. Rule 10(1)(b) of the Code provides:

> ***10 When offeror does not hold or control more than 50% of the voting rights***
> *(1) If, on the date of a partial offer, the offeror does not hold or control more than 50% of the voting rights in the target company, the partial offer must be 1 only of the following:*
> *…*
> *(b) a partial offer for a specified percentage of the voting securities of each class not already held or controlled by the offeror that, when taken together with the voting securities already held or controlled by the offeror, confers 50% or less of the voting rights in the target company if approval is obtained in accordance with the following provisions:*
> *(i) the takeover notice and the offer must include a statement that approval is sought under rule 10 of the Takeovers Code and that the offer is conditional on approval being obtained:*
> *(ii) the offer must be accompanied by a separate approval document providing for the offeree to approve or object to the offeror making an offer for 50% or less of the voting rights in the target company:*
> *(iii) approval under this rule is obtained if the offerees so approving hold more voting rights in the target company than are held by offerees so objecting:*
> *(iv) for the purposes of subparagraph (iii), voting rights held by the offeror and its associates must be disregarded:*
> *(v) for an approval or objection to be valid for the purposes of this rule, the completed approval document must be received by the target company or its agent before the expiration of the offer period.*

64. Thus, under rule 10(1)(b), a partial offer which would result in the offeror having voting control in the target company of 50% or less must be approved by the offerees (in other words, approved by the target company shareholders other than the offeror). A simple majority in favour of the offer, of votes that are cast, is required for the approval (that is, more votes must be cast in favour than votes cast against, and the voting rights of the offeror and its associates must be disregarded for this purpose). The offerees are not compelled to vote but any vote is only valid if it is received by the target company before the close of the offer period. The outcome of the vote is determined once the offer is closed.

65. Rule 43 of the Code provides:

> ***43 Who are the offerees***
> *(1) The offerees in respect of an offer are the persons shown as the holders of securities in the target company to which the offer relates on the securities register of the target company as at the record date.*
> *(2) Nothing in subclause (1) prevents the offeror from sending the offer to persons who acquire securities in the target company to which the offer relates after the record date.*

66. Rule 43 specifies which persons are "offerees" for the purposes of making an offer under the Code. In other words, rule 43(1) defines the persons to whom the offer document must be sent within three days of the date of the offer (rule 43B). In addition, rule 3(1) of the Code (the interpretation clause) defines "offeree" as "a person to whom an offer is made."

67. Accordingly, a person is an "offeree" if:

    (a) The person is a registered shareholder in the target company as at the record date (rule 43(1)); and/or

    (b) The person acquires securities in the target company after the record date (rule 43(2)); and/or

    (c) An offer is made to the person (rule 3(1)).

68. By considering rules 3(1) and 43(1) together with the voting procedure under rule 10(1)(b), it appears that any person who holds voting securities in a target company from the time of *the record date* of a partial offer is a person who is entitled to vote in the offer approval process under rule 10(1)(b).[20]

69. However, during the offer period, a person who holds voting securities in the target company as at the record date ("the transferor") may transfer some or all of its securities to a third party ("the transferee"). As a result of rule 43(2), the transferee is also entitled to be sent the offer that has been made by the offeror. The transferee is, therefore, an "offeree" for the purposes of the offer.

70. The implication of rule 10(1)(b)(iii) is that the transferee, who is an "offeree", appears to also be entitled to vote on whether to approve of the partial offer (the offer document must be accompanied by an approval form: rule 10(1)(b)(ii)). The problem, however, is that the transferor, despite having disposed of its shares, may also be considered to be an "offeree" because:

    (a) The transferor is "a person to whom an offer is made". Therefore, under rule 3(1) the transferor satisfies the Code's definition of an "offeree";

    (b) That transferor is also a person who was named in the securities register as a shareholder in the target company as at the record date. The transferor is therefore, also considered to be an "offeree" by virtue of rule 43(1) of the Code.

71. The issue then is, if voting securities in a target company are traded during the course of a partial offer that is conditional on shareholder approval, whether the transferor or the transferee (or both) is (or are) entitled to vote. On a strict reading of the Code, it could be agreed that both the transferor and the transferee would be entitled to vote under rule 10 in respect of the *same* parcel of shares because both persons satisfy one or other of the Code's definitions of "offeree". In other words, the shares could be double-voted.

72. In relation to the recent partial offers for Auckland International Airport Limited ("AIAL") and Rubicon, the Panel expressed its view that *only* those persons who are the registered holders of target company voting securities *as at the record date* should

[20] The assumption here is that the offer is one that would result in the offeror holding *50% or less* of the total voting rights in the target company and to which rule 10(1)(b) accordingly applies.

be entitled to vote for the purposes of rule 10(1)(b). The Panel took this view because it was consistent with the policy of shareholder voting under the Companies Act 1993. The Panel's view provided the most transparent process possible, under the current wording of the Code, for ensuring that there could be no double voting of shares that were traded during the offer period.

73. In the AIAL and Rubicon cases, the Panel's view was accepted by the parties to the relevant transactions. The difficulty, however, is that the view is not binding and relies on the cooperation of the parties. Further, that view remains open to a challenge on the basis of the apparent inconsistencies in the drafting of the Code. The Panel is interested in the suggestions of market participants on the most effective means for resolving this issue.

Issue 4: Dilution of offeror's shareholding during offer period

74. As discussed above, a partial offer must be made for a specified percentage of voting securities in the target company not already held or controlled by the offeror. The calculation of the specified percentage depends upon the percentage of voting rights in the target already held or controlled by the offeror and the percentage of the total voting rights in the target company that the offeror wishes to acquire through the offer (see Figure 1 above). The specified percentage is calculated as at the date of the offer[21] and is thereafter fixed for the offer's duration.

75. A potential risk for an offeror is that, subsequent to the date of the offer, the percentage of voting rights in the target company already held or controlled by the offeror is *diluted* (for instance, as a result of a non-pro rata allotment of voting securities by the target company). If the offeror's percentage holding has been reduced as a result of the dilution, this may mean that even if the offeror receives acceptances in respect of voting securities equal to the specified percentage, the offeror may not reach its desired total percentage of the voting rights in the target company.

76. The dilution issue is of particular importance in relation to the minimum acceptance condition in an offer. Rule 23(1) of the Code provides:

> ***23 Minimum acceptance condition***
> *(1) If, on the date of the offer, the offeror does not hold or control more than 50% of the voting rights in the target company, the offer must be 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, confer –*
> *(a) more than 50% of the voting rights in the target company; or*
> *(b) in the case of a partial offer, any lesser percentage approved under rule 10(1)(b).*

77. Rule 23 requires an offer made under the Code to be subject to a minimum acceptance condition. The minimum percentage of acceptances is calculated with reference to the *total* percentage of voting rights in the target company that the offeror would hold or control if the offer is successful. If that total is 50% or less, the minimum percentage of acceptances must be the percentage that offerees approve under rule 10. If the total is more than 50% (i.e. a full offer, but could also include a partial offer), the minimum acceptance percentage may be any percentage greater than 50%.

78. The effect of a dilution may be that, even though the offeror receives acceptances in respect of voting securities equal to the specified percentage, when the acceptances are taken together with the number of voting rights already held or controlled by the offeror (which now represents a lower percentage than the offeror had as at the date of the offer), the acceptances may not confer enough voting rights to satisfy the minimum acceptance condition in the offer. In other words, but for the diluting effect of the allotment by the target company during the offer period, the offeror would have been able to satisfy the minimum acceptance condition.

79. An offeror might anticipate a dilution prior to making its offer if it can ascertain whether the target company has options or convertible securities on issue which can

[21] Rule 10(1).

be converted into voting securities. An offeror, in the case of a partial offer that would result in the offeror holding or controlling *more than 50%*, can mitigate the risk of dilution by:

(a) Setting its specified percentage for the offer high enough such that any dilution would not create a risk that of non-fulfilment of the minimum acceptance condition; and

(b) Setting the percentage for the minimum acceptance condition *lower than* the total voting control percentage that the offeror would have on obtaining the specified percentage without a dilution[22] (provided, to comply with rule 23(1)(a), the minimum acceptance percentage is set at more than 50%).

80. Dilution is a more significant problem where an offeror makes a partial offer that would confer on the offeror voting control of *50% or less* in the target company. With such an offer, the minimum acceptance condition for the purposes of rule 23(1) must be "*any lesser percentage* approved under rule 10(1)(b)."

81. Rule 10(1)(b) is set out at paragraph 63 above. For present purposes, it is noted that the offer document "must be accompanied by a separate approval document providing for the offeree to approve or object to the offeror making an offer for 50% or less of the voting rights in the target company".[23]

82. The minimum acceptance percentage for a partial offer which would confer on the offeror voting control of 50% or less is *fixed* to the percentage approved by the offerees under rule 10. The percentage approved by the offerees is the sum of the percentage of voting rights already held or controlled by the offeror (as at the record date) together with the specified percentage in the offer. Therefore, if the offeror is diluted during the offer, it will be impossible for the offeror to satisfy the minimum acceptance condition, even if the offeror receives acceptances equal to the specified percentage.

83. It could be argued that rule 10(1)(b) does not require the approval form to state an *exact* percentage to be approved by the offerees. The practical implication, however, is that, by reading rule 10(1)(b) in light of rule 23(1)(b), the approval form must state precisely the total percentage of the voting rights in the target company that could be conferred on the offeror as a result of the partial offer. Rule 23(1) refers to, for the purposes of the minimum acceptance condition in a partial offer, "any lesser percentage approved under rule 10(1)(b)". If the approval form only referred to the offeree approving or objecting to the offeror making an offer for "50% or less of the voting rights in the target company", it would be impossible to calculate a percentage for the purposes of the minimum acceptance condition.

84. The purpose of fixing the minimum acceptance condition to the percentage to be approved by the offerees is two-fold:

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[22] I.e. allowing for the dilution to occur and setting the minimum acceptance condition at the level that would be achieved by receiving acceptances for the specified percentage that when taken together with the (now diluted) percentage of voting rights already held or controlled by the offeror, would confer the minimum acceptance condition percentage.

[23] Rule 10(1)(b)(ii).

(a) The offerees (i.e. target company shareholders), under a partial offer, do not have the opportunity to completely exit from their holding in the target company. The voting procedure, therefore, allows the offerees to approve or object to a change of control of the company in which they retain an interest. They must be informed as to what level of change of control will occur, and

(b) The condition incentivises the offeror to set an offer consideration which reflects the price of obtaining approval of the offerees (in other words, an "approval premium").

85. The offer by Canada Pension Plan Investment Board ("CPPIB") for Auckland International Airport Limited ("AIAL") in 2007/08 is the first example to date where the dilution problem has occurred.[24] The problem was identified in the draft offer documentation which accompanied CPPIB's announcement of its intention to make a partial offer for 39.53% of the voting rights that it did not already hold or control in AIAL. CPPIB already held a small percentage of AIAL voting rights, and intended to increase to a 40% holding through the partial offer.

86. It was likely that new shares would be issued by AIAL during the offer period as a result of the exercise of options held by employees. If all of AIAL's outstanding options were exercised during the offer period, CPPIB's final shareholding (upon taking up the specified percentage of 39.53%) would be 39.99%.

87. CPPIB proposed to state the minimum acceptance condition in the offer as follows:

"This Offer is further conditional on the Offeror receiving acceptances by no later than the Closing Time in respect of not less than the Specified Percentage of Outstanding AIAL Shares which will, if those acceptances are received, based on the number of Shares on issue as at [the record date], confer on the Offeror 40% of the voting rights in AIAL"

88. The proposed wording was intended to address a dilution of CPPIB's shareholding during the offer period. The specified percentage in CPPIB's offer would always remain the same (39.53%). But, because CCPIB already held voting rights in AIAL, if the existing voting percentage was diluted during the offer period, it would be impossible for CPPIB to reach the minimum acceptance percentage of 40% because it could not acquire (under the offer) any more securities than the specified percentage would confer.

89. The Panel considered that the draft condition appeared to be an attempt to contract out of the Code. The Panel thought it would be more appropriate to grant an exemption to resolve the anomaly. Accordingly, after an application by CPPIB, the Panel granted an exemption from rule 23(1)(b) of the Code to enable CPPIB to state a minimum acceptance percentage of 39.99%, a percentage which was different from the 40% percentage which was to be approved under rule 10(1)(b).[25]

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[24] The offer was made by NZ Airport NC Limited, a wholly-owned subsidiary of CPPIB incorporated for the purposes of the offer.

[25] *Takeovers Code (NZ Airport NC Limited) Exemption Notice 2007*. The exemption was subject to the condition that a summary of the terms and conditions of the exemption be disclosed in the offer document, in a form approved by the Panel.

Issue 5: Extending the offer period for partial offers

90. Rule 24 of the Code sets out the parameters for the duration of offers made under the Code:

> ***24 Offer period***
> *An offer must specify the period for which it will remain open and, subject to rules 25(4) and 26(1), must remain open for that period. The offer period must-*
> *(a) commence with the date of the offer; and*
> *(b) be not shorter than 30 days, and not longer than 90 days.*

91. The offer period must be specified in the offer document. The offeror may, subsequent to sending out its offer, extend the specified offer period by way of a variation of the offer. The offer period cannot (except in circumstances not relevant to a partial offer) be extended beyond 90 days in total.[26]

92. Rule 33 of the Code requires the payment of consideration to acceptors no later than seven days after the latter of the following three events:

(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 document.

93. If the acceptances of a partial offer are subject to scaling (which is almost always the case), the acceptances must all be received by the offeror to work out the scaling. This can only occur when the offer has closed. The offeror must know the amount of any excess acceptances it has received before the offeror can calculate the number of further securities it will take up from those offerees who accepted the offer in respect of greater than the specified percentage of their securities.

94. The Panel is concerned that a situation may arise where an offeror extends its offer period after it has gone unconditional and is obliged by rule 33 to settle in respect of acceptances that the offeror has already received. Given that the acceptances will likely need to be scaled (and that scaling can only occur once the offer has closed), an offeror who makes the extension will be unable to comply with the requirement to pay the offer consideration to any early acceptors of the offer. It will not know how many of the early acceptors' securities it can take up under the offer (unless, by chance, all early acceptances were for the specified percentage or less). Moreover, if the offer was for 50% or less, it would not know whether the shareholder approval requirement had been met and, accordingly whether it could take up any securities at all.

95. The Panel has not noted any particular instance to date where this problem has in fact occurred in a partial offer. However, the Panel and legal advisers to bidders under partial offers have been alive to the issue. The Panel wishes to consider the extent of any problem and, if required, the most appropriate means for addressing any issue. Accordingly, it would be grateful for comments on this from practitioners.

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[26] Rule 24A(1).

Issue 6: Votes cast by the offeror and its associates

96. As noted above, if a successful partial offer would result in the offeror holding or controlling 50% or less of the total voting rights in a Code company, the offer must be conditional on the approval of the offerees being obtained in accordance with rule 10(1)(b) of the Code.

97. Rule 10(1)(b)(iv) provides that, for the purposes of the approval voting procedure, the voting rights of the offeror and its associates must be disregarded. The Panel commented on this provision in its July 2009 Determination in relation to Rubicon Limited:

> *The wording of rule 10 of the Code does not, at first blush, appear to prohibit the offeror and its associates from voting on the rule 10 approval. Rule 10(1)(b)(iv) states that "voting rights held by the offeror and its associates must be disregarded". This contrasts with rule 17 of the Code which imposes an explicit prohibition on parties to an acquisition under rule 7(c) or to an allotment under rule 7(d) from voting on that resolution. Rule 17(1) provides that "the persons acquiring and disposing of the securities and their associates must not vote on a resolution for the approval" of a rule 7(c) acquisition or a rule 7(d) allotment.*[27]

98. The Rubicon matter was the first instance where the Panel considered the implications of voting by the offeror under rule 10(1)(b). The Panel took the view that rule 10(1)(b) should be read in light of rule 64 of the Code. Rule 64 provides:

> ***64 Misleading or deceptive conduct***
> *(1) A person must not engage in conduct that is-*
> *(a) conduct in relation to any transaction or event that is regulated by this code; and*
> *(b) misleading or deceptive or likely to mislead or deceive.*
> *(2) A person must not engage in conduct that is-*
> *(a) incidental or preliminary to a transaction or event that is or is likely to be regulated by this code; and*
> *(b) misleading or deceptive or likely to mislead or deceive.*

99. In the Rubicon Determination, the Panel noted that rule 64 is a provision with general application in relation to Code-regulated events. The rule colours all other provisions of the Code and, as such, "[c]onduct which may otherwise appear to be permitted by a Code rule, may, when interpreted in the light of the rule 64 prohibition, be effectively prohibited in certain circumstances."[28] On that basis, the Panel considered that "the combined effect of rule 10 and rule 64 is to effectively prohibit shares owned by the offeror and its associates being voted on rule 10 approvals."[29]

100. It is not clear the extent to which any lack of clarity regarding the effective prohibition in rule 10(1)(b)(iv) is in fact a problem. The Panel would be interested in hearing the market's views in this regard.

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[27] Para 131, http://www.takeovers.govt.nz/decisions/2009/determination-rubicon.htm.
[28] Ibid, para 132.
[29] Ibid, para 134.

Objective

101. The Panel's objective is to ensure that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies.

102. The Panel would be grateful for comments regarding the extent to which market participants believe that this objective is appropriate. Are there other objectives that should be considered?

Options

103. The Panel has considered various ways in which it might address the issues identified above. The Panel's options are set out below.

Issue 1: Treatment of nominee and custodial holdings for scaling of acceptances

Option 1: Maintain status quo – literal interpretation of rules 12 and 13

104. Under this option, the share register is paramount and the Panel would not intervene if parties adopt the prima facie literal interpretation of the word "offeree" in rules 12 and 13 of the Code. This would mean that any person who is the beneficial owner of securities held by a custodian or nominee in a target company could potentially have a greater portion of the person's securities taken up under the scaling provisions, than if the person held securities directly in the target company.

Why not preferred option?

105. The literal application of rules 12 and 13 may create a perverse incentive for persons to transfer securities to a nominee in order to take advantage of the benefits they might not otherwise be entitled to. It also means that some shareholders are treated differently from other shareholders, who do not have the opportunity to have the same proportion of their securities taken up than they would if their securities were held by a nominee.

106. One of the objectives of the Code is to assist in ensuring that shareholders in a takeover are treated fairly.[30] The literal interpretation of rules 12 and 13 of the Code, as discussed above, could be regarded as resulting in the inequitable treatment of some shareholders in the scaling process. This outcome is undesirable.

107. This inequitable outcome is contrary to the Panel's objective of ensuring that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies.

Option 2: Purposive interpretation of rule 12

108. It is arguable that a purposive interpretation could be applied to the word "offeree" in rules 12 and 13 of the Code. One of the objectives of the Code is to ensure that

[30] Takeovers Act 1993, s 20(1)(c).

shareholders are treated fairly, so, to that end, it would appear to be appropriate to "look though" a holding by nominee or custodian to the underlying beneficial owner, and treat that beneficial owner as if it were a direct holder of securities in the target company, for the purposes of scaling of acceptances.

109. Section 5(1) of the Interpretation Act 1999 provides that:

> The meaning of an enactment [i.e. the Code] must be ascertained from its text and in light of its purpose.

110. There are several arguments in favour of a purposive interpretation of "offeree":

(a) While the definition of "offeree" in rule 43(1) is narrow (an offeree is a person who is a registered shareholder as at the record date), the definition of offeree in rule 3(1) of the Code has much broader application. An offeree, under rule 3(1), is "a person to whom an offer is made". Given that the underlying owner of the securities is the one who ultimately enjoys the benefits of the offer, it is reasonable to consider that person as being the one to whom the offer is, in effect, made, for the purposes of the scaling of acceptances.

(b) A nominee or custodian holds securities as a bare trustee (i.e. in name only) for the underlying beneficial owner. The underlying owner enjoys all the benefits of owning the securities, which include, among other things, the right to participate in any offer to acquire those securities.

111. If the Panel were to adopt a purposive interpretation the word "offeree" in rules 12 and 13, the Panel could advise the market and practitioners of its position by way of a Guidance Note.

Why not preferred option?

112. There is a possible downside risk in the Panel adopting a purposive interpretation. Under the literal interpretation of "offeree", any person who is the beneficial owner of securities held by a custodian/nominee and who accepts a partial offer in respect of more than the specified percentage of their securities, may have the additional benefit of being able to dispose of a greater proportion of their securities. Accordingly, were the Panel to adopt an interpretation of "offeree" that would, effectively, deny such a benefit to such a person, it creates a risk that the Panel's interpretation will be disputed. For the underlying owner of the securities, the difference between the literal interpretation and the purposive interpretation of "offeree" may be one of financial significance (for an example, please refer to the hypothetical offer in Appendix A).

<u>Option 3: Class exemption</u>

113. Under this option, the Panel would grant a class exemption from rules 12 and 13 of the Code (the scaling provisions) to any offeror who receives acceptances in respect of a partial offer from a person who holds securities in a target company as a custodian or nominee.

114. The exemption would be subject to conditions which, in effect, require that, for the purposes of scaling, the offeror must look through the holding of the custodian or nominee and treat the underlying beneficial owners of the relevant securities as if those owners hold securities directly in the target company.

115. The Panel's intention would be to ensure that there is no distortion in the scaling of acceptances of a partial offer, by virtue of some acceptances being received from custodians or nominees.

116. By way of a relevant New Zealand example, a look through provision is included in a Securities Act 1973 exemption with respect to share purchase plans undertaken by NZX-listed issuers.[31] A share purchase plan is an offer by a listed company to its shareholders to subscribe for no more than $5,000 worth of new shares in any 12-month period. The offer is subject to simplified disclosure requirements. The offer must be to all shareholders and on the same terms and conditions.

117. The exemption contains a look through provision in respect of shares in the issuer held by custodians.[32] The custodian is required to certify that it is, in fact, holding securities as a custodian for beneficial owners, the number of those beneficial owners, how many securities each owner wishes to take up, and that the custodian will not take up securities on behalf of any beneficial owners who have already taken up their $5,000 entitlement in any 12-month period.

Why not preferred option?

118. The benefit of a class exemption is that it would address the issue raised by the holdings of custodians/nominees and ensure that all shareholders' acceptances in a partial offer were given equitable treatment in the scaling process. Such an outcome would achieve the Panel's objective that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies.

119. However, it is arguable that the class exemption would be constitutionally inappropriate - a "back door" change to the law; a change which should be effected through secondary (rather than tertiary) legislation (i.e., a change to the Code itself). The class exemption might be acceptable as a temporary measure if a recommendation was made by the Panel to the Minister of Commerce that the Code be changed

<u>Option 4: Amendment to the Code (preferred option)</u>

120. Under this option, the Panel would recommend to the Minister an amendment to the Code to the effect that, for the purposes of scaling, the offeror must look through the holding of the custodian or nominee and treat the underlying beneficial owners of the relevant securities as if those owners hold securities directly in the target company.

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[31] *Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005*.
[32] Clause 5, *Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005.*

121. Such an amendment would achieve a similar effect as section 653B of the Australian Corporations Act (see paragraph 24) and clause 5 of the Securities Act (NZX – Share and Unit Purchase Plan) Exemption Notice 2005 (see paragraph 108). The amendment would incorporate certification requirements of custodians/nominees.

Why preferred option?

122. An amendment to the Code has the following advantages:

(a) It would definitively resolve any perceived inequality of custodial/nominee holdings being scaled more advantageously for the underlying beneficial owners than for direct owners, without the concern that a purposive interpretations of the existing provision of the Code might be challenged by a litigious beneficial owner deprived of a significant financial advantage;

(b) Consistency would be achieved between the Code and similar regulatory provisions in both New Zealand and Australia; and

(c) It would provide absolute certainty to the market and practitioners about the correct, and most equitable, application of the scaling provisions.

123. An amendment to the Code for the above reasons would ensure that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies.

Issue 2: Misstating the specified percentage

Option 1: Maintain status quo

124. Under this option, the Panel would not change its current practice for dealing with misstatements of the specified percentage. That is, the offeror may state the correct specified percentage in its offer document (rather than re-issuing a takeover notice with the corrected specified percentage stated in the draft offer document and beginning the offer procedure again) provided the target company directors consent to this and the offeror promptly makes a market announcement explaining the change.

Why not preferred option?

125. The current practice deals adequately with "friendly" takeovers. However, if the situation arises in a hostile or contested takeover, it leaves the directors of the target company in control of a Code-compliance issue. This can be an uncomfortable position to be in and, from a regulatory perspective, is not wholly satisfactory.

126. Maintaining the status quo does not resolve the confusion that persists around how to state the specified percentage correctly. It also leaves an offeror vulnerable to regulatory action for a potential breach of the Code (for example, a misstated specified percentage may be considered to be misleading or deceptive under rule 64 of the Code).

Option 2: Class exemption

127. Under this option, the Panel would grant a class exemption from rules 9(3) and 9(4) of the Code to any offeror in respect of any misstatement of the specified percentage in the draft offer documentation which accompanies a notice of intention.

128. The exemption would be subject to conditions which require, effectively, that the offeror may state the correct specified percentage in its offer document (rather than re-issuing a takeover notice and beginning the offer procedure again) provided the target company directors consent to this and the offeror promptly makes a market announcement explaining the change.

129. The class exemption would be intended to codify the Panel's current practice in respect of misstatements of the specified percentage in offer documentation.

Why not preferred option?

130. The target company directors still have control of a Code-compliance issue and this may be inappropriate, especially in respect of a hostile or contested takeover. Nor does Option 2 address any underlying confusion about how the specified percentage works.

131. Option 2 would, however, reduce, for those offerors for whom the conditions of the exemption could be satisfied, the potential for regulatory action being taken for the original misstatement of the specified percentage. It may not deal with rule 64 having been breached, though, because for the period of time between the issuing of the takeover notice (which has the misstatement included in the accompanying draft offer document) and the issuing of the formal offer document, persons could be misled about the actual percentage that the offeror wanted to obtain.

Option 3: Guidance Note / inclusion of an example in Rule 9 (preferred option)

132. Under this option, the Panel would publish a Guidance Note which sets out an example of how to calculate the specified percentage. The Panel would also recommend to the Minister an amendment to rule 9 of the Code, so that it sets out an example calculation of the specified percentage for a partial offer.

133. The Panel would also continue its current practice in the event that a misstatement did occur.

Why preferred option?

134. A better response to the problem ought to be one which avoids misstatements occurring in the first place.

135. A Guidance Note, which the Panel could publish within a short timeframe, would raise awareness among market participants that the misstatement of the specified percentage is a relatively common issue but is relatively simple to avoid. Although it may not eliminate future misstatements, by including an example calculation a Guidance Note, it would increase understanding in the market about the specified

percentage and thereby reduce the likelihood of misstatements occurring in the future. It might also prompt prospective offerors to check with the Panel executive that the specified percentage is correctly stated, prior to issuing a takeover notice.

136. A Guidance Note's drawback is that it is only a secondary reference for practitioners. It may be overlooked or be forgotten with the passage of time. The inclusion, however, of an example (perhaps an adaptation of Figure 1, above on page 2) in rule 9 of the Code itself would be the most effective means of raising awareness about how to correctly calculate the specified percentage. The example would be readily available to practitioners (and would always remain available) and should, thereby, greatly reduce the likelihood of future instances of misstatements of the specified percentage. The inclusion of examples in legislation is an increasingly common drafting practice (see, for example, the Personal Properties Securities Act 1999, which includes numerous examples).

137. Both of these responses, the Guidance Note and the example in rule 9, would educate market participants about the correct calculation of the specified percentage. An informed market would ensure that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies.

Issue 3: Identity of "offerees" for the purposes of rule 10(1)(b)

Option 1: Maintain status quo

138. Under this option, the Panel would continue to express its view to the parties of partial offers that only those persons who are the registered holders of target company voting securities *as at the record date* should be entitled to vote for the purposes of rule 10(1)(b).

Why not preferred option?

139. The benefit of the current practice is that it provides clear guidance to the parties to a partial offer as to who should be entitled to vote under rule 10. It consistent with the policy of shareholder voting under the Companies Act 1993 (which provides that at a shareholder meeting the persons entitled to vote are those who are registered shareholders as at the date of the notice of meeting: Companies Act 1993, section 125(3)).

140. There are two potential downsides, however, which may mean that maintaining the status quo does not meet the Panel's objective of ensure that partial offers are an effective and efficient mechanism for facilitating changes of control of Code companies:

(a) Any persons who acquire securities in the target company during the offer period and who retain any of those securities following the offer, do not have an opportunity to approve or object to a change of control of the company. Rather, the persons who dispose of their securities are the ones who may vote, despite the fact that they may no longer have an interest in the target company; and

(b) The Panel's view might be challenged on the basis of the apparent inconsistencies in the drafting of the Code. It could be argued that the Code allows double-voting in relation to the parcels of target company securities that have been traded during the course of a partial takeover. An offeror whose offer has failed because it was rejected by the shareholders, but where "double votes" had been disregarded, might want to challenge the outcome of the approval procedure and seek to have double votes counted.

Option 2: Amendment to the Code (preferred option)

141. Under this option, the Panel would recommend to the Minister an amendment to rule 10(1)(b) of the Code. The amendment could provide for either of the following:

(a) Only those persons who are registered holders of the target company securities *as at the record date* are entitled to vote ("Option 2a");

or

(b) Only those persons who are registered holders of the target company securities *as at the close of the offer period* are entitled to vote ("Option 2b").

Why preferred option?

142. The advantage of an amendment to the Code is that it would remove any uncertainty as to which person (either the "transferor" or the "transferee") is entitled to vote for the purposes of rule 10(1)(b). It would ensure that partial offers made under the Code are an effective and efficient mechanism for facilitating changes of control of Code companies, because:

(a) It would prevent the integrity of the rule 10(1)(b) voting process being undermined by offerees double voting;

(b) It provides a clear rule about whose votes are counted for the purposes of rule 10(1)(b); and

(c) It would remove any uncertainty that the outcome of a shareholder vote under rule 10(1)(b) could be challenged on the basis of the double voting issue.

143. The difficulty, however, is appropriately determining who the eligible person should be. There are arguments that may be made for and against both Option 2a and Option 2b.

Option 2a – the eligible voter is the shareholder as at the record date

144. The voting process under rule 10(1)(b) would be consistent with the requirements for shareholder meetings under the Companies Act 1993 (which provides that only those persons whose names are registered on the company share register as at the date of a

notice of meeting are entitled to vote at that meeting).[33] Consistency would also be maintained with the approach adopted by the Panel in respect of the recent partial offers for AIAL and Rubicon.

145. The potential downside is that a person who acquires voting securities in a target company during the course of a partial offer does not have an opportunity to approve or object to the offeror making an offer for the company in which the person holds securities. Moreover, since the votes can be cast at any time until the closing date of the offer,[34] a person may have traded all their target company shares and still have the opportunity to vote on the outcome of a takeover in which they no longer have an interest.

146. However, any person who acquires voting securities in a company subject to a partial offer after the record date ought to be aware that they do not have the right to vote under rule 10 and, to the extent that the voting right would be priced into the transaction, the price which they pay for the shares should reflect the absence of that right. By virtue of this, the downside risk of the proposed amendment under Option 2a would be mitigated.

Option 2b – the eligible voter is the shareholder as at the close of the offer

147. Unlike in a full offer, the shareholders in a target company subject to a partial offer do not have an opportunity to completely exit the company. The offeree approval procedure, therefore, gives the shareholders an opportunity to approve or object to a change in control of the company in which they will have a ongoing interest once the offer is completed.

148. Where securities in the target company are traded during the offer period, if the transferor is eligible to vote under rule 10 (as in Option 2a), and the transferee, who is the one that remains in the target company after the offer, has no say in the change of control, this would appear to be inconsistent with the ongoing interest principle. Accordingly, option 2b would address the inconsistency and ensure that it is the person with the ongoing interest in the target company who has the opportunity to vote under rule 10.

149. The downside, however, is that there might be practical difficulties for the target company in processing votes cast by persons who acquired securities during the offer period. The target would have to have a sufficiently sophisticated system to be able to ensure that votes had not previously been cast in respect of the securities. In order to be certain which votes count, the target company would have to wait until the offer had closed and then determine which was the last (and current) owner of the share parcel who voted (otherwise votes could be cast in respect of the same securities on multiple occasions as a result of multiple trades). This may be a significant administrative burden for small target companies (or their agents).

[33] Companies Act, s 125(3),

[34] Rule 10(1)(b)(v) requires that the vote be received by the target company or share registrar before the offer period expires.

Issue 4: Dilution of offeror's shareholding

Option 1: Maintain status quo

150. Under this option, the Panel would continue to consider whether to grant exemptions to deal with instances where the percentage of voting securities held or controlled by an offeror in a target company is diluted during the course of a partial offer.

151. The exemption granted in relation to CPPIB's partial offer for AIAL provides a useful precedent.[35] The Panel would deal with future instances on a case-by-case basis, and grant specific exemptions from rule 23(1)(b) of the Code if it considered it appropriate in the circumstances.

Why not preferred option?

152. An allotment of securities by a target company that results in an offeror's percentage of voting rights being diluted could occur whenever a target company has issued convertible securities, such as options or warrants (which is common place in the New Zealand market).

153. Although the problem may be addressed by the granting of an exemption by the Panel (such as in the CPPIB/AIAL scenario) to enable to offeror to state a different minimum acceptance percentage, an exemption would need to be sought once the offer process had commenced. Exemptions should be sought as a last resort. It would be preferable for any potential problems to be solved prior to the giving of a takeover notice.

154. It may be difficult for an offeror to anticipate a dilution because the existence of convertible securities in the target company may not be public information (i.e. in the case of an unlisted company). Moreover, the class notice which the target company must send to the offeror no later than two days after receiving a takeover notice must specify, in the case of a partial offer, each class of *voting securities* the target company has on issue.[36] Any non-voting convertible securities would not, therefore, need to be disclosed to the offeror.

155. In light of the above factors, maintaining the status quo does not appear to meet the Panel's objective of ensuring that partial offers are an effective and efficient mechanism for facilitating changes of control of Code companies.

Option 2: Amendment to rule 23(1)(b) (preferred option)

156. Under this option, the Panel would recommend to the Minister an amendment to rule 23(1)(b) of the Code.[37]

157. The amendment would provide that the stated percentage may decrease, to the extent of any dilution during the offer period of the percentage of voting rights already held

[35] Takeovers Code (NZ Airport NC Limited) Exemption Notice 2007.
[36] Rule 42A(1)(b).
[37] Rule 23(1)(b) is set out at paragraph 66.

or controlled by the offeror, if the target company undertakes an allotment of new securities during the offer period.

158. The amendment would include qualifications to the effect that the dilution must be as a result of an allotment of voting securities by the target company that is beyond the control of the offeror and was made under an obligation of the target company which preceded the notification of the particular partial offer (or the reasonable belief of the target company directors that a bona fide offer was imminent).

Why preferred option?

159. The proposed amendment would facilitate the progress of partial offers made under the Code. It seems unreasonable that the issuing of shares by the target company as a result of the conversion of convertible securities into shares (which is beyond the offeror's control) should frustrate a takeover offer.

160. The suggested qualifications to the proposed amendment ensure that any change to the minimum acceptance percentage would only be allowed when the circumstances relate to a new share issue. In the CPPIB exemption, the dilution occurred as a result of the exercise of options held by AIAL employees. The exercise of options was a matter beyond the control of CPPIB. AIAL would have been obliged to allot the new shares upon the exercise of any options because of its agreements with the option holders (which pre-existed the CPPIB offer).

161. The proposed amendment would not affect the percentage specified in the approval form sent to offerees in accordance with rule 10(1) of the Code. This is important because, in the event of a dilution, the percentage in the approval form (i.e. the total voting control percentage which the offeror would hold if the offer was successful, excluding any dilution) would be greater than the percentage for the purposes of the minimum acceptance condition. Therefore, if the offerees approve the offeror reaching the percentage stated in the approval form, by implication the offerees would approve the offeror taking up a lesser percentage (due to the dilution).

162. The proposed amendment would result in a fair and certain outcome for any offerors who are diluted during the course of an offer, and further the Panel's objective of ensuring that partial offers are an effective and efficient mechanism for facilitating changes of control of Code companies.

Issue 5: Extending the offer period of partial offers

<u>Option 1: Maintain status quo (preferred option)</u>

163. Under this option, the Panel would take no action to address the issue and the status quo would be maintained.

164. The Panel encourages practitioners to discuss proposals for takeovers, well in advance, with the Panel executive. This can be done on a "no names" basis and provides an opportunity to explore potential issues regarding an offer, such as the implications of rule 33 on scaling for a partial offer.

Why preferred option?

165. The extent of this problem is unclear at this stage (the Panel has not had to consider a situation where rule 33 could not be complied with in relation to a real transaction). It would, therefore, seem to be appropriate to deal with any problems which do arise on a case-by-case basis, whether as a matter of enforcement under Part 3 of the Takeovers Act, or by way of exemption, or a combination of the two.

166. There does not appear to be any practical way around this problem. Acceptances in a partial offer will almost always be subject to scaling, which can only be done once the offer is closed. The Panel would be interested to know whether practitioners believe any change needs to be made to the Code to deal with this issue, and if so, what such a change might state.

Issue 6: Votes cast by the offeror and its associates for approval of an offer for 50% or less of target

Option 1: Maintain status quo

167. Under this option, rule 10(1)(b)(iv) would remain unchanged. The correct interpretation of the rule would be that which the Panel decided on in the Rubicon determination (2009) (i.e. that there is, by virtue of the combined effect of rule 10 and rule 64 of the Code, a prohibition on voting by the offeror and its associates).

Why not preferred option?

168. Although the Panel's Rubicon determination effectively has the force of law and provides an authoritative explanation to the market as to the application of rule 10, it does not mean that, if an offeror or its associate did vote, they would breach rule 10 of the Code directly (rather than indirectly through a breach of rule 64, as happened in the Rubicon partial offer).

Option 2: Amendment to the Code (preferred option)

169. Under this option, the Panel would recommend to the Minister an amendment to rule 10(1)(b)(iv) of the Code. The amendment would provide that, for the purposes of a vote under rule 10 of the Code, any voting by the offeror and its associates is prohibited.

Why preferred option?

170. Although the Panel made its view clear in the Rubicon determination that rule 10(1)b)(iv) amounts to an effective prohibition on voting by the offeror and its associates, this view stops short of indicating that, in a situation where the offeror (or its associate) was a holder, rather than a beneficial owner through a chain of nominees and voted, that would be a breach of rule 10.

171. The proposed amendment would enact in the Code the Panel's interpretation of rule 10(1)(b)(iv) in its Rubicon determination and make rule 10(1)(b)(iv) consistent with

rule 17 of the Code, which clearly prohibits voting by an allottee or acquirer and associates on a resolution for approval of a rule 7(c) or 7(d) acquisition or allotment.

172. For the above reasons, the proposed amendment would provide a fair and certain solution to the issues raised by voting by the offeror and its associates, and would ensure that partial offers are an effective and efficient mechanism for facilitating changes of control of Code companies.