TECHNICAL AMENDMENTS
TO THE TAKEOVERS CODE

RECOMMENDATIONS TO THE MINISTER OF COMMERCE
FROM THE TAKEOVERS PANEL

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INTRODUCTION

1. One of the Takeovers Panel's functions, as provided by section 8(1)(a) of the Takeovers Act 1993, is to keep under review the law relating to takeovers of specified companies and to recommend to the Minister of Commerce any changes to that law that it considers necessary.

2. The Takeovers Code came into force on 1 July 2001. The Panel has been responsible for the administration of the Code since that time.

3. The Panel is committed to making the Code work and making it work well. The present proposals for amendment to the Code relate to rules 56 and 57 of the Code and arise from the Panel's experience with the Code in the past year.

4. The proposed amendments bring together recommendations for amendment to the Code published on the Panel's website www.takeovers.govt.nz in March and November 2004.

5. To ensure widespread exposure of its recommendations the Panel distributed a detailed discussion paper in December 2004 to a large number of recipients. Submissions were requested by 25 February 2005. A copy of the Panel's discussion paper is **attached**.

6. To provide the greatest level of assistance to the target audience of the main professional law firms the Panel's paper included proposed drafting changes to the Code. These proposals were put forward on the basis that the final responsibility for drafting any changes to the Code remains with Parliamentary Counsel Office.

7. The Panel received eight substantive responses to its discussion paper, these being from:

   (a) Chapman Tripp

   (b) First NZ Capital

   (c) Horwath Porter Wigglesworth

   (d) Institute of Financial Professionals New Zealand Incorporated

   (e) The New Zealand Law Society

   (f) NZX

   (g) Russell McVeagh

   (h) Simpson Grierson.

8. This level of responses was not unexpected. The Panel's proposals are of a technical rather than a policy nature. They are of principal interest to practitioners actively involved in the takeover market.

9. The Panel has carefully considered these responses. As a result some of its original drafting of the proposed amendment to rule 56(3) of the Code has been amended.

10. This paper puts forward the Panel's final proposals for amendments to the Code. It outlines the Panel's original proposals and comments on submissions received on those proposals before detailing the Panel's final recommendations.

11. In order to assist the preparation of drafting instructions to Parliamentary Counsel Office the paper includes detailed drafting suggestions for each proposed amendment to the Code put forward by the Panel.

12. The technical amendments discussed in this paper concern:

    A. Proposed amendment to rule 56 of the Code

    B. Proposed amendment to rule 57 of the Code.

Regulatory impact

13. While the proposals are intended to improve the operation of the compulsory acquisition procedures under the Code, they are of a minor nature that do not substantially alter existing arrangements.

Compliance costs

14. The Panel's proposals should result in little to no increases in compliance costs for market participants. In particular they could result in a reduction in compliance costs for market participants by avoiding the unnecessary appointment of an independent adviser in certain circumstances of compulsory acquisition.

The Panel's recommendation to the Minister of Commerce

15. **The Panel recommends that the Minister seek Cabinet authority to amend the Takeovers Code as proposed in this paper.**

John King
Chairman
Takeovers Panel

RECOMMENDATIONS FOR PROPOSED AMENDMENTS TO THE TAKEOVERS CODE

A: Proposed amendment to rule 56 of the Code

Proposal

16. The Panel proposes that outstanding security holders (those who have not accepted a takeover offer):

    (a) in circumstances where a dominant owner has obtained dominant ownership through a takeover offer; and:

    (b) the dominant owner has received acceptances in respect of more than 50% of the equity securities that were the subject of the offer; and

    (c) the takeover offer for the voting securities contained more than one consideration alternative; and

    (d) the takeover offer provided that one of the consideration alternatives was the default consideration alternative in the event that an offeree accepting the offer did not indicate which consideration alternative he or she wished to receive;

    would be given the right, when returning their instruments of transfer under rule 59, to specify which of the consideration alternatives provided in the offer they wish to receive in exchange for the securities being compulsorily acquired.

Rationale for proposed change

17. Under rule 56(1) of the Code, if a person becomes the dominant owner by reason of acceptances of an offer, and acceptances have been received in respect of more than 50% of the class of equity securities under offer, the consideration payable in respect of equity securities must be the same as the consideration provided under the offer for equity securities in the same class.

18. However, rule 56(3) states that if the offer provides alternative considerations, then the consideration payable under compulsory acquisition will be the consideration payable under the offer if an accepting offeree fails to choose an alternative or, if no provision to that effect is included in the offer, is the alternative consideration containing the greatest cash component.

19. It is open to an offeror to specify alternative considerations under an offer and to nominate one of those alternatives as the default consideration in the event an accepting security holder does not nominate the alternative it wishes to receive. There is no requirement under the Code that each consideration alternative be in the same form, or have the same value, as long as the offer is made on the same terms and provides the same consideration to all offerees.

20. The effect of rule 56(3) is that any shareholders whose shares are compulsorily acquired by the dominant owner will be given the default alternatives, and will have no choice in the matter. The outstanding shareholders have no right under the Code to object to the consideration.

21. This outcome could be particularly unfair, and is likely to have quite a coercive effect in any takeover. An offeror, by including an unattractive and unfair default consideration alternative in its offer, could effectively force shareholders to accept a takeover offer for fear of being compelled to take the unwanted consideration alternative under compulsory acquisition.

22. The sentiment of rule 56 is clear. If there is no default consideration specified in the offer then shareholders whose shares are compulsorily acquired are to get the alternative with the greatest cash component. But the practical effect of the clause is just the opposite. Offerors can stipulate the least attractive consideration alternative as being the default consideration and that will be the one that they will have to pay under compulsory acquisition, should they reach that point of dominant ownership and have achieved 50% acceptances of the equity securities that were under offer in the takeover.

23. The Panel's recommended change to ameliorate the problem caused by the present construction of rule 56(3) is to require the dominant owner to give security holders whose securities are being compulsorily acquired under rule 56(1) and (2) (i.e. where there is an offer and acceptances of the class of securities under offer are over 50%) the ability, when they return their instruments of transfer under rule 59, to specify which of the consideration alternatives that were available under the offer they wished to be paid in exchange for their securities.

24. All outstanding security holders in these circumstances would have the opportunity to stipulate the consideration they wanted to receive during the compulsory acquisition process, even if not all choose to exercise that right. Offerees could no longer use an aspect of the Code to coerce offerees into accepting an offer they did not want, solely to avoid the undesirable compulsory acquisition outcome.

25. The Panel believes it is important that the compulsory acquisition provisions should be as outcome-neutral as possible. The Panel's suggested drafting aims to achieve this.

Comments of respondents

26. Almost all the submissions received supported the rationale underlying the proposed changes to rule 56 of the Code. Of the eight submissions, seven were in favour of the proposal. There was one substantive submission opposed to the Panel's proposal. This came from a major law firm. The submitter's view is that offerees who do not accept a takeover offer should not get the benefit of being able to choose which alternative consideration they would like under compulsory acquisition. Having that right, the submitter argues, would be a disincentive to offerees to accept a takeover offer.

27. The Panel is not persuaded by this argument. It is possible, in structuring an offer with different consideration alternatives, to make one alternative much more attractive than the other. The combination of an attractive consideration alternative and an

unattractive default alternative can have a coercive effect which the Panel believes is unfair. The Panel accordingly has retained its proposal and has made only a minor change to the drafting of the proposed changes to rule 56 of the Code.

28. This minor drafting change was proposed by another of the submissions. The relevant submission suggested the removal of the words "following the close of the offer period" from the draft wording of rule 56(3) as outlined in the Panel's discussion document. The submitter did not consider that consideration paid out after the close of an offer could be different from consideration paid out before the close of an offer.

29. On reflection, the Panel agreed with the submission and noted that, all shareholders must always receive the same consideration irrespective of when payment is made. The wording of rule 56(3) should not suggest otherwise.

30. In light of the submission the Panel amended the wording of the proposed drafting by removing the words "in the form in which accepting offerees of that alternative were paid out following the close of the offer" from the proposed wording of rule 56(3) of the Code.

Compliance Costs

31. There should be no compliance costs associated with this proposal. The only cost associated with this proposal is the opportunity cost for offerees of losing the ability to exploit the compulsory acquisition rules in a coercive manner in a takeover offer.

Recommended change

32. The Panel recommends that, in the applicable circumstances of compulsory acquisition outlined above:

(a) Rule 56(3) be amended to provide that where;

i. a dominant owner has attained dominant ownership through acceptances of an offer; and

ii. the acceptances comprise more than 50% of the class of securities under offer; and

iii. the takeover offer for the voting securities included more than one consideration alternative; and

iv. the takeover offer identified one of the consideration alternatives as the consideration that would be paid where an accepting offeree did not specify the consideration alternative it wished to take;

then:

v. the outstanding security holder, when returning his or her instrument of transfer under rule 59, would be given the option to choose which of the consideration alternatives available under the offer it wished to be paid.

vi. The amendment would provide that the amount to be paid would be the same as the consideration paid to an accepting shareholder under the offer.

vii. If the outstanding security holder did not nominate the consideration alternative it wished to be paid then the present rules of the Code would apply.

(b) Rule 55(c), relating to the contents of the acquisition notice, and rules 60 and 61, relating to the return or non-return of the instrument of transfer to the dominant owner, would be consequentially amended to ensure consistency.

Recommended drafting change

33. The Panel has suggested the following drafting change to incorporate this recommendation in the Code (changes are underlined).

That rule 56(3) be amended to provide:

If the offer provided for alternative considerations, then the consideration payable under subclause (1) is the consideration alternative chosen by an outstanding security holder when returning his or her instrument of transfer under rule 59 or, if the outstanding security holder fails to return an instrument of transfer in the time required by rule 59 or does not choose a consideration alternative, is the consideration payable under the offer if an accepting offeree failed to choose an alternative or, if no provision to that effect was included in the offer, is the alternative consideration containing the greatest cash component.

That rule 55(c) be consequentially amended so that the acquisition notice would:

Specify the consideration to be provided for the outstanding securities, including, where rule 56(3) applies, the consideration alternatives from which the outstanding security holder may choose if they elect to do so and the consequences of not so choosing;

That rules 60 and 61 be consequentially modified. Rule 60 would need to state:

If an outstanding security holder returns to the dominant owner the documents referred to in rule 59, the dominant owner must send the consideration specified in the acquisition notice, or in any case where rule 56(3) applies, determined in accordance with that rule, to the outstanding security holder within 7 days after the dominant owner receives the documents referred to in rule 59.

That rule 61 would be correspondingly changed:

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

(a) deliver to the code company the consideration specified in the acquisition notice, or in any case where rule 56(3) applies, determined in accordance with that rule, in respect of which the documents referred to in rule 59 have not been returned to the dominant owner; and …

B: Proposed amendment to rule 57 of the Code

Proposal

34. Rule 57 relates to the determination of consideration in certain types of compulsory acquisition that follow a takeover offer.

35. It is proposed that the Code be amended to so that a rule 57(1) adviser will no longer be required where a person attains dominant ownership through a takeover offer that was for cash or had a cash alternative, and acceptances were received for 50% or less of the equity securities under the offer. In substance the compulsory acquisition price would be the offer price and no rule 57 adviser would be required. However outstanding security holders would still have the right to object to the price.

36. The proposal only affects compulsory acquisition following a takeover offer. It does not affect compulsory acquisition when no takeover offer is involved.

Rationale for proposed change

37. The purpose of the Panel's proposed amendment is to limit the time-consuming and costly requirement of commissioning an extra independent adviser's report to those circumstances where there is likely to be genuine benefit from it.

Existing Code requirements

38. Currently under the Code, a rule 57(1) adviser is required following a takeover offer when a person becomes the dominant owner of a Code company by reason of acceptances of the offer, but the compulsory acquisition price for the remaining securities is not determined by rule 56.

39. Rule 56 determines the price when acceptances are received in respect of more than 50% of the equity securities that are the subject of the offer. If this occurs, the compulsory acquisition price will be the consideration payable under the offer whether this is cash, non-cash, or a combination of both (rule 56(2)). Outstanding security holders have no right to object to that price. (See the Panel's proposals for amendment to rule 56(3) to give outstanding security holders the right to choose a consideration alternative.)

40. However, rule 56 does not determine the price if acceptances are received for 50% or less of the equity securities that are the subject of the offer. If this occurs, the consideration payable is set by the dominant owner, but must be a cash sum certified as fair and reasonable by an independent adviser pursuant to rule 57(1). Outstanding security holders are able to object to the proposed consideration (rule 57(2)). If within 14 days after sending the acquisition notice, the dominant owner receives written objections to the consideration from outstanding security holders who hold the lesser of:

(a) 2% or more of a class of equity securities; or

(b) 10% or more of the outstanding securities of a class,

the dominant owner must immediately refer to expert determination the amount of consideration to be provided to outstanding security holders (rule 57(3)). The expert for these purposes will be an independent person appointed by the Panel (rule 58).

41. The expert will determine the amount to be paid by the dominant owner to all outstanding security holders. If it is higher than the acquisition price all outstanding security holders will receive the increased amount. However, if it is lower, all outstanding security holders can be required to return the difference to the dominant owner.

Rule 57(1) adviser not necessary in certain circumstances

42. The Panel considers that the rule 57(1) adviser is an unnecessary additional imposition where the takeover offer was for cash or had a cash alternative. Shareholders have already received valuation advice through the rule 21 report on the merits of an offer. This generally provides a range for the offer price that the adviser considers is fair consideration for the target company. If the offer fails to achieve more than 50% of acceptances of the shares under offer, for whatever reason, it does not need another independent adviser to advise on the value of the target company for the purposes of compulsory acquisition. Instead, shareholders should be told they will receive the same consideration as under the offer and can object to that price. If sufficient security holders object then the rule 57(3) expert will provide an authoritative decision on the consideration to be paid for the remaining securities.

43. However, the position is different where the offer was not for cash, and did not carry a cash alternative, and failed to achieve more than 50% acceptances. In this situation, the compulsory acquisition must be for cash. As no cash price has been put forward in the offer and been the subject of a rule 21 report, an independent adviser's report is appropriate. Objections can then be lodged to this price and if the thresholds are met, expert determination will apply.

44. There are several costs in obtaining a rule 57(1) report. First, it is a reasonably substantial expense for what is the second or third independent adviser's report required under the offer. Secondly, it may be time consuming to find both an appropriately qualified and experienced and sufficiently independent person to prepare the report. It may be particularly difficult to meet the independence threshold set by the Panel, as the Panel considers that an adviser who has previously acted in relation to the transaction (for example, by preparing a rule 21 report) should not generally advise again.

45. For these reasons, it appears warranted to remove the requirement for a rule 57(1) adviser from the Code where the compulsory acquisition results from a takeover offer which was for cash or contained a cash alternative, but did not meet the requirements of rule 56(2) in achieving in excess of 50% acceptances of the securities for which the offer was made.

Comments of respondents

46. Eight submissions were received in relation to the proposed changes to rule 57 of the Code. All eight submissions were in favour of amending rule 57 of the Code. The Panel has made no changes to its original proposals.

Compliance costs

47. The Panel's proposal should result in compliance costs and direct costs being reduced by avoiding the unnecessary appointment of an independent adviser in certain circumstances of compulsory acquisition.

Recommended change

48. The Panel recommends that the Code be changed to require an independent adviser's report under rule 57(1) only where:

(a) there was no takeover offer made; or

(b) a takeover offer was made; and

(i) the takeover offer was not for cash or did not include a cash alternative; and

(ii) acceptances were received for 50% or less of the equity securities under the takeover offer.

49. This recommendation is supplementary to the proposals set out in section N (Compulsory acquisitions) of the Panel's Technical Amendments to the Takeovers Code (December 2003).

Recommended drafting change

The Panel has suggested a drafting change to incorporate this recommendation in the Code.

Proposed replacement rule 57(1):

(1) If the consideration cannot be established under rule 56, the consideration specified in the acquisition notice –

(a) must –

(i) be a cash sum certified as fair and reasonable by an independent adviser; or

(ii) where –

(A) a person becomes the dominant owner by reason of acceptances of an offer (whether or not the dominant owner has also acquired equity securities under rule 36); and

(B) the consideration under the offer was a cash sum or included a cash alternative; and

(C) acceptances of the offer were received in respect of 50% or less of the equity securities that were the subject of the offer in the class in respect of which consideration is to be determined,

be the same cash sum or cash alternative provided as consideration under the offer for equity securities in the same class; and

(b) is the consideration payable for the outstanding securities.

APPENDIX 1

PROPOSED AMENDMENTS TO THE COMPULSORY ACQUISITION PROVISIONS OF THE CODE – A DISCUSSION DOCUMENT