RECOMMENDATIONS TO THE MINISTER OF COMMERCE BY THE TAKEOVERS PANEL

PROPOSAL

1. The Takeovers Panel recommends five minor amendments to the Takeovers Act 1993 ("the Act"). Four of them propose clarifications to the definition of "specified company" in the Act and "code company" in the Code. The other recommendation proposes the correction of a small error in section 8 of the Act, arising out of amendments made to the Act in 2006 under the Securities Legislation Bill ("SLB").

2. The aim of the four main proposals is to reduce direct and indirect costs to the market by increasing certainty or by removing from the Takeovers Code's ambit companies that were not intended to be caught as Code companies.

BACKGROUND

3. The definition of "specified company" in the Act and "code company" in the Code provides:

> ***Specified / code company*** *means a company that –*
>
> *(a) is a party to a listing agreement with a registered exchange and that has securities that confer voting rights quoted on the registered exchange's market; or*
>
> *(b) was within paragraph (a) at any time during a period specified in the takeovers code (being a period not exceeding 12 months before any date or the occurrence of any event referred to in the code); or*
>
> *(c) has 50 or* more *shareholders*

4. Under this definition any company with 50 or more shareholders is a Code company. A recently de-listed company remains a Code company for 12 months after delisting.

5. The Panel has identified the following four problems with the definition:

   (a) The definition of 'specified company' in the Act is the same as the definition of 'code company' in the Code. The definition should only be in the Act, and the difference in terms (specified company/Code company) is unnecessary and confusing;

   (b) Transactions or events that start under the Code obviously must finish under the Code. However the drafting of the definition of 'code company' creates doubt about that;

   (c) The Act does not define the meaning of 'shareholder' for '50 or more shareholders'. There is uncertainty in the market as to whether 'shareholders' means all shareholders whose names are entered on the company's share register, or whether joint shareholders are to be counted as one shareholder;

   (d) The '50 or more shareholders' definition catches those shareholders who are holding securities that do not confer voting rights, even though the Code is concerned only with changes of control of voting rights.

DISCUSSION

Terminology: 'specified company' 'code company; definition in the Act only

6. In the Act a company that is subject to the Code is called a "specified company". In the Code, such a company is called a "code company." In both cases the definitions are the same. The market has accepted and adopted the term Code company. Such a key definition (all of the Code's obligations and rights flow from it) should not be in secondary legislation, and using different terminology for the same definition is also inconsistent and annoying.

7. Aside from maintaining the status quo, the Panel considered two options:

   (a) Changing the "specified company" terminology in the Act to "code company" and defining it in the Act by reference to the definition of "code company" in the Code. This option was not preferred because it would only resolve the annoyance issue;

   (b) The preferred option is that the "specified company" terminology in the Act be replacing with "code company", and that the Act is the only source of the definition of "code company".

8. This proposal would resolve an anomaly in terminology that causes irritation, and would ensure that any changes to the definition would be changes to primary legislation and subject to the direct scrutiny of Parliament.

9. Hereafter in these recommendations all references used are to 'Code company'.

Start with the Code, finish with the Code

10. Rule 6 of the Code is the 'fundamental rule'. Under rule 6, a person may not increase their percentage of voting rights "in a code company" unless, after that event, they hold or control (together with their associates) not more than 20% of the voting rights "in the code company". The fundamental rule relies on the definition of Code company, i.e., a company that is listed, de-listed within the last 12 months, or has 50 or more shareholders.

11. It has been questioned whether the Code still applies if a company no longer, on a literal interpretation, meets the Code company definition of having "50 or more shareholders" midway through a Code regulated transaction or event. The problem has arisen in relation the requirements for compulsory acquisition, where a shareholder becomes a "dominant owner". The dominant owner definition provides that a "dominant owner, in relation to a code company", means a person who becomes the holder or controller of 90% or more of the voting rights "in a code company". A Code offer may result in there being less than 50 shareholders at the time the 90% threshold is reached.

12. If the Code no longer applied, the dominant owner would lose its ability to compulsorily acquire the last few percent of voting rights in the company, shareholders would lose their Code protections, and the Panel would lose its powers to intervene and supervise the takeover or compulsory acquisition. The problem with

the status quo, therefore, is one of legal uncertainty. The Panel takes the view that the Code continues to apply through to the completion of the transaction.

13. The Panel proposes that this problem be solved by adding a clarifying provision to the definition section of the Act, to clarify that a company remains a Code company for the duration of any Code regulated transaction or event (including for a subsequent compulsory acquisition resulting from a takeover or other Code-regulated transaction or event). This would ensure clarity and remove any argument that the Code can cease to apply mid-transaction.

Clarifying '50 or more shareholders'

14. The market has raised the question as to how the '50 more shareholders' definition of Code company is to be interpreted. Some share parcels are held by more than one person; for example, two or more trustees may hold a parcel of shares jointly on trust for beneficiaries. Should each individual shareholder in the company be counted, or the number of share parcels that are held?

15. The Panel has considered this question and has decided that the correct interpretation is that *shareholders* means each shareholder named in the company's share register. This is consistent with the definition of shareholder in section 96 of the Companies Act 1993. The Panel published its decision in a *Guidance Note* in December 2007.

16. However the Guidance Note is only an interpretation; the law remains uncertain.

17. The Panel considered two options:

    (a) Counting share parcels rather than individual shareholders. This option was not preferred because the Companies Act defines 'shareholder' by reference to the persons whose names are entered in the share register. However, defining 'shareholder' by share parcel would be consistent with the approach in the Australian takeovers legislation and was favoured by some practitioners commenting on the Panel's 2007 Guidance Note.

    (b) The <u>preferred option</u> is to define 'shareholders' to mean the persons whose names are entered in the share register.

18. The preferred option effectively maintains the status quo (under the Panel's Guidance Note) while providing legislative certainty. The proposed definition is also consistent with the definition of shareholder in the Companies Act. It is sensible for these two pieces of related legislation to remain as consistent with each other as practicable.

*50 or more shareholders – only holders of **voting** securities?*

19. There are a number of companies (perhaps around 40) that have issued non-voting shares to large numbers of shareholders but that have fewer than 50 shareholders with voting rights in the company. These companies must comply with the Code regardless of the fact that they have very few shareholders with voting rights. The Panel cannot exempt such companies from being Code companies.

20. Maintaining the status quo would leave companies that have very few voting shareholders subject to the compliance costs of the Code. The Panel therefore proposes that the Code company definition be amended to only include companies with 50 or more shareholders who hold securities that confer voting rights.

21. In 2006 the definition of Code company was amended so that listed companies with only non-voting securities (e.g. debt securities) quoted on a registered exchange were no longer captured by the definition. No change was made in respect of the type of shareholdings for un-listed companies. The question was simply not addressed then. It should be addressed now.

Error in section 8 of the Act

22. In the 2006 amendments to securities and takeovers law under the SLB, some small, consequential amendments to section 8 of the Act were inadvertently missed, resulting in unintentional and inconsistent references in the Act. Section 8 sets out the Panel's functions. In section 8 there are three references to 'Part III':

> *"**8 Functions of Panel***
> *(1) The Panel has the following functions:*
> *…*
> *(d) To investigate any act or omission or practice for the purpose of exercising its powers and functions under **Part III** of this Act:*
> *(e) To make determinations and orders and make applications to the Court in accordance with **Part III** of this Act:*
> *…*
> *(g) To perform such other functions as are conferred on it by this Act.*
> *(2) In the exercise of its functions and powers under **Part III** of this Act and the takeovers code, the Panel shall comply with the principles of natural justice.*"

23. Under the SLB the numbering of the Act's Parts was changed from Roman to Arabic numbers; Part III became Part 3; and Part III was divided into two Parts, with a new 'Part 4' introduced to separate miscellaneous powers (such as the Panel's exemption powers) from the Panel's investigation and enforcement powers. Thus the old Part III has now become Parts 3 and 4.

23. There was no intention that the SLB change the Panel's functions under section 8 of the Act. However, it could be argue that, by separating Part III into two new Parts and leaving the references in section 8 unchanged, Parliament intended to limit the Panel's functions in some way.

24. To solve the problem the Panel proposes that the references in section 8 to Part 'III' be replaced with Parts '3' and '4', as appropriate, to restore the original meaning.

FINANCIAL IMPACT

25. None of the proposals imposes any costs or disadvantages to the market or to the Government.

26. The proposals to move the definition of Code company into the Act, to clarify that a transaction that begins under the Code remains regulated by the Code until its completion, and to fix the error in section 8 of the Act, merely clarify the current status of the law.

27. The market appears to have generally accepted the Panel's interpretation that *shareholders* means the persons whose names are entered on the share register. Market participants will have taken this interpretation into consideration when arranging their affairs (or when having re-arranged them as a result of the Panel's 2007 Guidance Note). Accordingly, there are no costs arising from this proposal.

28. The proposal to remove from the definition those companies with 50 or more shareholders holding non-voting shares would reduce compliance costs for a small number of companies that are currently Code companies, by removing these companies from the application of the Code.

CONSULTATION

29. The Panel has not yet consulted the market on these minor proposals. It is proposed to consult the market on them under a draft Takeovers Amendment Bill, in conjunction with consultation on the proposals in the Panel's other set of recommendations in relation to schemes and amalgamations involving Code companies (if Cabinet agrees to the proposed changes and to consultation in this form).

RECOMMENDATIONS

30. In accordance with section 8(1)(a) of the Takeovers Act 1993, the Panel recommends that the following changes be made to the Takeovers Act 1993:

    (a) that-

        (i) the term 'specified company' in the definition section of the Act be replaced with 'code company';

        (ii) all references in the Act are changed from 'specified company' to 'code company';

        (iii) the substantive part of the definition of 'code company' is removed from the Code and replaced with a reference to the definition of 'code company' in the Act; and

        (iv) rule 2(3) of the Code is revoked and paragraph (b) of the definition in the Act is consequentially amended to reflect that change.

    (b) The Panel recommends a legislative change to clarify that a company remains a Code company for the duration of any Code regulated transaction or event (including for a subsequent compulsory acquisition resulting from a takeover or other Code-regulated transaction or event);

    (c) The Panel recommends legislative clarification in the TA to support the 'individual shareholder' definition, which would be consistent with section 96 of the Companies Act 1993;

    (d) The Panel recommends that the 'code company' definition be amended by adding, in paragraph (c), after the words '50 or more shareholders', the words 'holding securities that confer voting rights', or words to that effect;

    (e) The Panel recommends that the references in the Act to 'Part III' in –

        (i) section 8(1)(c) be changed to 'Parts 3 and 4';

        (ii) section 8(1)(d) be changed to 'Part 3'; and

        (iii) section 8(2) be changed to 'Parts 3 and 4'.