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CLASS EXEMPTIONS FOR BUYBACKS

A CONSULTATION PAPER ISSUED BY THE TAKEOVERS PANEL

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INTRODUCTION

1. The Takeovers Panel is seeking public comments on the class exemption for buybacks contained in clause 4 of the Takeovers Code (Class Exemptions) Notice (No 2) 2001 (“Class Exemptions”) which this paper reviews.
2. The review originates from concerns of the Panel about the operation of clause 4 of the Class Exemptions, and in particular about the reliance placed by Code companies on shareholder approval where a buyback occurs over several years.
3. In conducting its review the Panel is able to draw upon its approximately 8 years of experience in enforcing the Code.
4. This discussion paper begins by describing the current regulatory environment in which buybacks occur and identifies a number of problems with clause 4 of the Class Exemptions. The discussion paper then defines the policy objective for resolving the problems with clause 4 of the Class Exemptions, sets out a range of potential options for addressing the problems, and assesses the potential options against the defined objective.

Request for comments on this paper

5. The Panel invites submissions on the issues raised in this paper and the options identified for addressing the issues.
6. The closing date for submissions is Friday 12 June 2009.
7. Submissions should be sent to the Takeovers Panel –
 - By email - takeovers.panel@takeovers.govt.nz
 - By post - Takeovers Panel
Level 8 Unisys House
56 The Terrace
P.O. Box 1171
WELLINGTON; or
 - By fax - +64 4 471 4619.
8. 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.

PROBLEM IDENTIFICATION

Background

9. Under a buyback a company acquires its own shares. A company may undertake a buyback in a number of ways, including:
 - by the company making an offer to each shareholder to buyback a uniform percentage of each shareholder's shares (a pro-rata buyback)
 - by the company entering into an agreement with 1 or more shareholders to buyback their shares
 - by the company buying its shares on-market
10. The Takeovers Code is relevant to buybacks because shareholders who are (together with their associates) near to or over the 20% threshold of rule 6 of the Code may have their control percentage increased as a result of a buyback and therefore potentially breach rule 6 of the Code. While acquisitions and allotments occur as the result of a conscious decision and positive action, buybacks can potentially result in inadvertent breaches of the fundamental rule because the increase in voting control is a result of non-action (i.e., non-participation in the buyback) on the part of the person needing to rely on the clause 4 class exemption. Provided the conditions of exemption are complied with, the person who increases, as a result of a buyback, over the 20% threshold in the fundamental rule will not breach the Code.

Status quo

11. The fundamental rule of the Code contained in rule 6 is that no person can:
 - increase their control percentage to more than 20% (together with their associates) of the voting rights in a Code company; or
 - increase an existing control percentage of 20% or more (together with their associates) of the voting rights in a Code company.
12. Rule 7 of the Code provides for various exceptions to the fundamental rule. The exceptions that are relevant for the purposes of this review are those contained in rule 7(c) and rule 7(d).
13. Under rule 7(c) a person may become the holder or controller of an increased percentage of the voting rights in a Code company by an acquisition of voting securities approved by ordinary shareholder resolution in accordance with the Code. Rule 15 sets out the requirements for the notice of meeting containing the proposed resolution in respect of the acquisition (i.e., sets out the information that the notice of meeting must contain, or be accompanied by,

including disclosure of the number of shares in the company that may be acquired and the percentage of shares that that number represents).

14. Rule 7(d) and rule 16 which relate to allotments rather than acquisitions are almost identical to rule 7(c) and rule 15.
15. Rule 7(c) and rule 7(d) reflect a key principle of the Code that an increase in voting rights, that would otherwise breach the fundamental rule, should be permitted with the approval of the Code company's shareholders by ordinary resolution.
16. Prior to the Code's coming into force on 1 July 2001, the Panel granted the Class Exemptions. These cover a range of situations that, in the absence of an exemption, could lead to inadvertent breaches of the fundamental rule. Among the Class Exemptions are 2 which relate to buybacks by Code companies of their own shares. These 2 exemptions are the clause 4 class exemption for buybacks approved by shareholders and the clause 5 class exemption for buybacks not approved by shareholders. The clause 4 class exemption was drafted to mirror the shareholder approval mechanism contained in rule 7(c) and rule 15 of the Code.¹
17. Clause 5 of the Class Exemptions provides an exemption for buybacks that are not approved by shareholders under clause 4. It is a condition of the exemption that the exempted person whose control percentage increases as a result of a buyback eliminates the excess control percentage within 6 months and the additional voting rights are not exercised before that decrease.
18. Buybacks where clause 4 is being relied upon by a shareholder whose voting control would increase under the buyback require the appointment of an independent adviser to prepare an independent adviser's report. The number of independent adviser approval applications received by the Panel over the last 8 years indicates there has been approximately 1 company buyback per year requiring shareholder approval for the purposes of clause 4 (i.e. utilising the clause 4 exemption).
19. The Panel does not hold statistics for the number of buybacks where clause 5 has been utilised because no application or notification is required to be given to the Panel under clause 5.
20. The clause 4 class exemption (which is the focus of this review) provides a mechanism for a person to increase their control percentage in a Code company above the 20% threshold of the fundamental rule by not selling into a buyback. The clause 4 class exemption allows the person relying on it to achieve that increase (that is, they are exempted from the rule 6 prohibition against increasing above the 20% threshold) with the approval (by an ordinary

¹ The Statement of Reasons for the clause 4 exemption states: "*the exemption is appropriate and is consistent with the objectives of the Code because it closely mirrors the shareholder approval mechanism, which is an exception to the fundamental rule, set out in rules 7(c) and 15 of the Code.*"

resolution) of the shareholders of the company, who are not associates of the exempted person.

21. The shareholders make this decision on the basis of disclosure in the notice of meeting of the details of the potential maximum of the increase in the exempted person's voting control that could occur as a result of that person not participating in the buyback. In addition, an independent adviser provides a report on the merits of the buyback from the perspective of the shareholders who will have to consider whether or not to accept the offer (if it is not a "special offer" to just 1 or a few shareholders). The independent adviser also opines on the merits of the buyback in terms of its impact on voting control in the company, from the perspective of shareholders who can vote to approve or reject the buyback for the purposes of the exempted person's proposed voting control increase.
22. The clause 5 exemption has no equivalent in the Code. It provides a method to eliminate, over a reasonable period (i.e., 6 months), an increase in voting control that has not been sanctioned by the Code company's other shareholders and that therefore cannot be retained. The clause 5 exemption can be relied upon even if shareholder approval has actually been sought but it has not been given, under the clause 4 exemption. Thus, clause 4 enables an increase in voting control that occurs as a result of the buyback to be retained, while clause 5 exempts the increasing person from complying with the fundamental rule of the Code, but requires the inadvertent increase in voting control to be eliminated within 6 months. The Panel is not aware of any issues with the clause 5 class exemption, therefore this paper focuses on the clause 4 class exemption only.
23. The clause 4 class exemption is set out in full in Appendix 1.

Exemptions from rule 15(b) and rule 16(b) of the Code

24. The clause 4 class exemption is drafted so as to be consistent with and to closely mirror rule 7(c) and rule 15(b) of the Code which relate to acquisitions of Code company shares by a new or existing shareholder. As noted above, rules 7(d) and 16 (which relate to allotments of Code company shares) are substantially identical to rules 7(c) and 15(b). We refer to the rules 7(c) and 15(b) and 7(d) and 16(b) provisions as the "Rule 7 Requirements".
25. The Rule 7 Requirements mandate the disclosure of the exact number and percentage of shares to be acquired or allotted. If the exact number and/or percentage of shares to be acquired or allotted cannot be specified under rule 15(b) or rule 16(b) (as the case may be) rule 7(c) and rule 7(d) will not be able to be relied upon in the absence of an express exemption from the Panel. The Panel has granted a number of exemptions that allow maxima to be stated in the notice of meeting for shareholder approval of acquisitions or allotments where this situation arises.
26. For example, exemptions from rule 16(b) have been granted in respect of:

- (a) underwriters of share issues who do not know how many shares they will subscribe for under the allotment as this is dependent upon whether, and to what degree, others subscribe;
 - (b) persons subscribing to rights to acquire shares under a rights issue who do not know what percentage of voting rights in the Code company they will hold as a result of the allotment as this is dependent upon whether, and to what degree, others subscribe;
 - (c) persons exercising rights to convert convertible securities into voting securities who do not know the total voting rights that will be on issue at the time of their conversion and allotment because there are other holders of the convertible securities who may or may not also exercise their conversion rights;
 - (d) persons exercising options to be allotted voting securities who do not know the total voting rights that will be on issue at the time they may elect to exercise their options because there are other holders of options who may or may not exercise them.
27. Exemptions from the Rule 7 Requirements are usually made subject to the following conditions (modified as necessary for the specific situation) in respect of the acquisition of voting securities by, or allotment of voting securities to, the person seeking to rely on the exemption:
- (a) all relevant voting control maxima are disclosed in the notice of meeting;
 - (b) all relevant voting control maxima have been calculated on the basis that there is no change to the number of voting securities on issue between the date of the notice of meeting and the completion of the allotment (or acquisition) except those that are issued under the allotment;
 - (c) full particulars of the acquisition/allotment are disclosed in the notice of meeting;
 - (d) the notice of meeting contains a summary of the terms and conditions of the exemption;
 - (e) the notice of meeting displays a disclaimer that the Panel is neither endorsing nor supporting the accuracy or reliability of the contents of the notice of meeting nor implying it has a view on the merits of the acquisition/allotment;
 - (f) the form of the notice of meeting is approved by the Panel;
 - (g) the proposed acquirers/allottees can only increase their voting control as a result of the transaction approved under the exemption;
 - (h) there is no effective change of control of any corporate acquirer/allottee for the time period specified in the exemption;

- (i) the proposed acquirers/allottees cannot increase their voting control at any time during the duration specified in the exemption to a percentage above the maximum percentage of voting securities that they could hold or control as disclosed to shareholders in the notice of meeting;
 - (j) in cases where shareholder approval is obtained for a series of allotments occurring over several years, disclosures are also made about the control positions of the exempted persons, in the Code company's annual reports.
28. The Panel has stated in its statements of reasons for the granting of these exemptions that it considers the particular exemptions to be appropriate and consistent with the objectives of the Code because disinterested shareholders have an opportunity to vote on the acquisition/allotment and if they approve that acquisition/allotment on the basis of the maximum number of voting securities that could be acquired/allotted then, by implication, they can be taken to have approved the acquisition/allotment of a lesser number and percentage of voting securities.
29. The policy behind the conditions is to ensure that shareholders have the necessary information to make a fully informed decision when deciding whether to approve any increases in voting control.

Other legislation and rules

30. Other legislation that is relevant to a buyback is briefly described below.

Companies Act 1993

31. Buybacks by New Zealand registered companies are governed by sections 59 to 66 of the Companies Act 1993.
32. There is no requirement under the Companies Act that a buyback be approved by the shareholders of the company (except if the buyback constitutes a major transaction or if a "special offer" is made to buyback a particular shareholder's shares).
33. Other than in the case of special offers, a buyback may be undertaken by a company in 1 of 3 ways:
- (a) A pro rata offer made to all shareholders (section 60);
 - (b) An on-market offer, subject to prior shareholder notification. The offer must be made in the period between 10 working days and 12 months after sending the notification to the shareholders (section 63);
 - (c) An on-market offer, for up to 5% of the shares in a class. Shareholders must be notified of the acquisition within 3 months after the shares are acquired, and the stock exchange notified within 10 working days after the shares are acquired (section 65).

Securities Markets Act 1988

34. Under section 23 of the Securities Markets Act a substantial security holder (being a person that has a 5% or more relevant interest in a listed company's shares) must disclose by way of notice (an SSH Notice) to the listed company and the NZX any movement of 1% or more in their relevant interest. The NZX posts SSH Notices on its website, so any such change to a substantial security holder's interest in the company is publicly available. Hence, when a listed Code company undertakes a buyback, any 1% or more increase to its substantial security holders' control of voting rights would be disclosed to the market.

Listing Rules

35. Under the NZX Listing Rules, before a listed company acquires its own shares it must give notice to the NZX. This notice must specify the period of time within which the company will acquire the shares (which must be within 12 months from the date of the notice) and the maximum number of securities to be acquired in that period.
36. The Listing Rules also require post disclosure of certain details of the shares acquired (e.g. class and number of shares acquired, share price and the reason for acquisition).
37. Unlike the clause 4 class exemption the Listing Rules do not provide a mechanism whereby the maximum potential voting rights increases of specific persons are required to be disclosed.

Issues with clause 4 of the Class Exemptions

38. The Panel has identified several issues with the clause 4 class exemption and these are set out below. Market participants are invited to identify other issues with this exemption, and to give their views on the extent to which they agree or disagree with the problems that the Panel has identified.

Issue 1: Changes in ownership of exempted corporates

39. Buybacks (especially on-market buybacks) can occur over an extended period of time. In some cases a company will have a buyback programme in place so that it can buy back its shares on-market over a period of several years.
40. A corporate person (and those who control it) may rely on the clause 4 class exemption to obtain shareholder approval for its (and their) increase in voting control under a buyback. The ownership of that corporate person may change during the life of the buyback. However, the fundamental rule catches those who "control", as well as those who hold. Accordingly, due to the breadth of the fundamental rule, any substantial change in the ownership of the exempted corporate person could not occur without breaching the Code. This means that if there was to be a change of ownership of a corporate shareholder who

(together with associates) controlled more than 20% of a Code company, regardless of whether the corporate shareholder itself could continue to rely upon the clause 4 class exemption, the new person proposing to acquire the shares in the corporate shareholder would have to comply with the Code or obtain an exemption from the Panel before acquiring his or her or its position in the corporate shareholder. Accordingly, the Code already regulates changes of control upstream of a Code company, so the change of control itself is not really a problem.

41. The greater problem with exempted corporate shareholders, however, is that, although shareholder approval would need to be obtained for an effective change in the control of the corporate shareholder, the Code would not require the notice of meeting to disclose information about the potential future increases in control of the Code company by the corporate shareholder (or its controllers) under an ongoing long-term buyback programme. Accordingly, in this situation shareholders make their decision on whether to give their approval on a less than fully informed basis.

Issue 2: Shareholder approval given under “point in time” disclosure

42. Shareholder approval under the clause 4 class exemption is given under “point of time” disclosure (i.e. under those disclosures contained in (or accompanying) the notice of meeting for the approval resolution). Because a buyback may take place over several years, new shareholders coming in may be unaware of the maximum voting rights increases permitted to a person under the clause 4 exemption, as disclosed in the notice of meeting. Accordingly, to a certain extent, shareholders in the secondary market make investment decisions on a less than fully informed basis.
43. The shortcomings of point of time disclosure in the context of buybacks over an extended period are not remedied by the disclosure requirements under the Companies Act, Securities Markets Act or the Listing Rules, because none of these require disclosure of the maximum voting control increases permitted to a person under the clause 4 class exemption.

Issue 3: Basis for calculating disclosures not defined

44. The clause 4 class exemption is subject to the condition that the notice of meeting containing the proposed resolution to approve the acquisition contains particulars of the maximum number of voting securities that may be acquired by the Code company. It also requires that the notice of meeting sets out the percentage of all voting securities of the Code company that the maximum number represents, and the potential maximum aggregate of the percentages of all voting securities that the exempted person (and that person’s associates) would hold or control if the maximum number of voting securities were acquired. The above percentages can only be calculated with reference to the number of shares of the company on issue as at a specific date (and in the case of a buyback undertaken over a long period of time, on the assumption that there is no change in the number of voting securities on issue over that period, other than as a result of the buyback).

45. Many companies have convertible securities on issue that can be converted into shares at the holder's election. Accordingly, shares can be allotted (thus increasing the total number of shares on issue) at frequent intervals. The clause 4 class exemption does not define the assumptions for making the calculations, such as the date at which the number of shares of the company on issue should be calculated, and therefore there is lack of clarity surrounding the percentage calculation. Different percentages will be obtained depending on when the calculation is made. Some Code companies specify in the notice of meeting for a clause 4 shareholder meeting that the calculation date is the date that the notice of meeting is sent. Others specify a particular date in advance of the notice of meeting. Others may state that the calculation is based on the number of shares that will be on issue as at the date of the shareholders meeting (this might be appropriate where, for example, mandatory convertible notes will convert into shares on or before that date).
46. The lack of prescribed assumptions such as regarding the date for making the calculation means that the company must decide for itself the basis for the disclosure calculations. While this may be seen as positive for some (i.e. by allowing flexibility), for others it may cause confusion or anxiety as to whether the disclosures are Code compliant. The Panel would be interested in the market's views as to the extent to which this issue causes problems.

Issue 4: Wording of clause 4(2)(a) unclear

47. Under clause 4(2)(a) of the clause 4 class exemption, the exemption is subject to the condition that "the acquisition is approved by an ordinary resolution of the shareholders of the code company".
48. It is not clear on its face that the shareholder "approval" referred to in clause 4(2)(a) is approval only for the purposes of the Code (i.e., only so that the exempted person can increase without breaching the fundamental rule), not for the purposes of the Companies Act. Given that the Companies Act does not impose a shareholder approval requirement for buybacks (except, in certain circumstances, for a buyback that constitutes a "major transaction" or a "special offer" to buyback shares from only 1 or a few shareholders in the company), the Code company can still proceed with the buyback regardless of whether shareholder approval is obtained for the purposes of clause 4(2)(a).²
49. In the early years of the Code's operation an exemption was sought (and granted by the Panel (the Takeovers Code (Designer Textiles (NZ) Limited) Exemption Notice 2002)) on the basis that the directors of the company had announced a decision to undertake a buyback before shareholder approval was sought for Code purposes. This seems to indicate a narrow interpretation of the clause 4 class exemption, as though the requirement of shareholder

² If the buyback proceeds and shareholder approval is not obtained, the shareholder that had wanted to increase its control position in the company by not participating in the buyback would now either have to participate in the buyback or rely on the clause 5 class exemption (under which it would have 6 months to eliminate any control increase that had occurred as a result of the buyback).

approval was to authorise the buyback itself to occur, rather than to enable persons wishing to increase their voting control to do so.

Issue 5: Uncertainty over whether multiple resolutions permitted

50. There have been some instances that the Panel is aware of where there has been uncertainty over whether multiple resolutions are permitted in respect of the shareholder approval required by the clause 4 class exemption.
51. Whether multiple resolutions are permitted can be important because under clause 4(2)(b) the person seeking to rely on the exemption cannot vote in favour of the resolution. This means if there is a single resolution for the buyback and there is more than 1 person seeking to rely on the exemption, none of the exemption seekers could vote in favour of the resolution to approve the buyback. However if multiple resolutions are permitted each person would be entitled to vote in favour of the buyback on the resolutions relating to the other exemption seekers (provided they are not associates of the exemption seeker named in that resolution).
52. It is not clear on the face of the wording of the clause 4 class exemption that a separate resolution for each exemption seeker is allowed. The Panel's view is that multiple resolutions are permitted.
53. Neither of issues 4 and 5 is a very big problem, in the sense that legal practitioners can, and do, discuss with the Panel executive how clauses 4 and 5 of the Class Exemptions work. However uncertainty creates unnecessary compliance costs, and it is sensible to have regulations drafted in a manner that is clear and accessible to those regulated by them.

Issue 6: Incomplete disclosure of maximum voting control of exempted person

54. The clause 4 class exemption requires (by subclause (2)(c)(ii)(C)) that the notice of meeting in respect of the buyback contain, or be accompanied by, a statement of the maximum aggregate percentage of all voting securities that could be held or controlled by the exempted person and the exempted person's associates if all voting securities were acquired by the Code company under the buyback.
55. The clause 4 class exemption does not require the notice of meeting to disclose the maximum percentage of voting securities that could be held or controlled by the exempted person alone. Shareholders are left to determine for themselves, unless the disclosure is voluntarily included in the notice of meeting or is included in the independent adviser's report, what the exempted person's potential maximum control percentage might be. Such a statement in relation to the exempted person alone is required under the Rule 7 Requirements that the clause 4 class exemption is intended to mirror.
56. The absence of a requirement (in the clause 4 class exemption) of such a statement means that the clause 4 class exemption is inconsistent with the Rule 7 Requirements. It also means that shareholders make their decision on

whether to provide their approval to the buyback on a less than fully informed basis.

OBJECTIVE

57. The Panel's objective is to ensure that the class exemptions relating to buybacks operate effectively and efficiently while allowing for fully informed shareholders to decide for themselves whether or not specific voting control increases, that would otherwise breach the fundamental rule, should be permitted.

OPTIONS

58. The following 5 options have been identified as possible ways of addressing the above issues.

Option 1: Take no action

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

Why not the preferred option?

60. While none of the problems identified above appears to be of a very great magnitude, their cumulative effect has a negative impact on the effective and efficient operation of the clause 4 class exemption. As a result, the market is not fully informed (in relation to buybacks that occur over a long period of time). In addition, any uncertainties for Code companies and for shareholders relying on the clause 4 class exemption creates a compliance burden that could be eliminated by taking some action to remedy it.

Option 2: no policy changes but clarify wording of clause 4

61. Under this option, clause 4 is rewritten to clarify how it is intended to operate (i.e. no substantive changes are made to the clause 4 class exemption). In particular, the exemption would be rewritten to clarify:

- the assumptions, such as the date at which the number of shares of the company on issue should be calculated, for the purposes of specifying in the notice of meeting the percentage increases resulting from the buyback (for example, the date might be set as the date that is 7 days before the date of the notice of meeting, and it might be assumed that there will be no change to the number of voting securities on issue) (Issue 3)
- that the shareholder "approval" referred to in clause 4(2)(a) is for Code/Class Exemption purposes only (Issue 4)
- that multiple resolutions are permitted (Issue 5)

62. This option requires no policy changes. Therefore none of the compliance burden associated with changes to the law would be incurred by market participants. This option would improve certainty and would result in practitioners being better able to advise their clients, thus would improve the efficiency of the Code from the market's perspective.

Why not the preferred option?

63. This option does not address Issue 1 concerning changes in ownership of exempted corporates, Issue 2 concerning point in time disclosure or Issue 6 concerning incomplete disclosure of the maximum voting control of the exempted person. This means that shareholders would still not be fully informed when deciding for themselves whether or not specific voting control increases, that would otherwise breach the fundamental rule, should be permitted. Therefore this option does not meet the Panel's objective.

Option 3 – Limit the time over which the clause 4 class exemption could be relied upon and clarify wording in clause 4

64. Under this option, in addition to rewriting clause 4 to clarify its meaning, as for Option 2, the clause 4 class exemption would be amended to impose a time limit on the time over which the exemption could be relied upon by a person wishing to increase their control percentage, of, say, 12 months (or perhaps 2 years) from the date of shareholder approval.
65. This option has the benefit of addressing Issues 3, 4 and 5, as provided for in Option 2. It may also indirectly address Issues 1 (changes in ownership) and 2 (point in time disclosure) which arise from the long-term nature of some buybacks by ensuring that disclosures will never be more than 12 months (or perhaps 2 years) old.

Why not the preferred option?

66. This option is not the preferred option because long-term buybacks are undertaken for legitimate commercial reasons. A time limit of 12 months (or 2 years) would mean that where a buyback was being undertaken over several years, the person seeking to rely on the clause 4 class exemption would need to "refresh" their reliance on it every 12 months (or every 2 years). Such a process would be cumbersome and costly for the exempted person as it would necessitate that, among other things, the person sought shareholder approval (and obtained an independent adviser's report) each 12 months (or 2 years). This would cause a significant increase in compliance costs for such persons and for the Code company. In addition, this option does not address Issue 6 concerning incomplete disclosure of the maximum voting control of the exempted person. Therefore this option does not meet the policy objective of the exemptions relating to buybacks operating effectively and efficiently.

Option 4: Revoke the clause 4 class exemption

67. Under this option, the clause 4 class exemption is revoked and instead the Panel would grant buyback exemptions on a case by case basis.

68. This option indirectly addresses all of the issues by eliminating their cause; the class exemption itself.

Why not the preferred option?

69. This option would be the most heavy-handed approach to take. Revoking this class exemption would mean that the person wishing to rely on an exemption would need to apply to the Panel for a specific exemption. A specific exemption would put the applicant to significant additional expense (the cost recovery charged by the Panel for processing exemptions in this area averages between \$5,000 to \$15,000 per application depending on the complexity of the particular transaction and exemption). In addition to the Panel's costs, an applicant has their lawyers' fees (which may be greater than the Panel's costs) and the impact on their own time and productivity when dealing with the application. It would also be uncertain whether the Panel would necessarily grant the desired exemption and what conditions the Panel would impose if it did grant the exemption. For these reasons this option does not meet the policy objective of the exemptions relating to buybacks operating effectively and efficiently.

Option 5 –Amend and clarify wording of clause 4 conditions – mirror exemption conditions for rules 15(b) and 16(b) of Code (preferred option)

70. Under this option, in addition to rewriting clause 4 to clarify its meaning, as for Option 2, the clause 4 class exemption would be amended to incorporate a modified version of the standard conditions that the Panel requires when it grants exemptions from rule 15(b) and rule 16(b) of the Code (“Standard Exemption Conditions”)³ as follows:

- (a) all relevant voting control maxima are disclosed in the notice of meeting;
- (b) full particulars of the buyback are disclosed in the notice of meeting;
- (c) the notice of meeting contains a summary of the terms and conditions of the exemption;
- (d) the notice of meeting displays a disclaimer that the Panel is neither endorsing nor supporting the accuracy or reliability of the contents of the notice of meeting nor implying it has a view on the merits of the buyback;
- (e) the voting control maxima required to be disclosed in the notice of meeting are calculated:
 - (i) on the basis of the number of shares of the Code company on issue 7 days before the date of the notice of meeting; and

³ Depending on submitters' views on the proposed new conditions for the clause 4 class exemption, the Standard Exemption Conditions might then be modified to reflect the proposed new conditions for clause 4.

- (ii) on the assumption that, other than as a result of the buyback, there is no change to the total number of voting securities on issue between the date that was 7 days before the date of the notice of meeting and the completion of the buyback; and
- (f) the form of the notice of meeting is approved by the Panel;
- (g) if a buyback is undertaken over a period of more than 12 months, disclosures are also made about the control position of the exempted person, in each annual report of the Code company from the date of the shareholder meeting until the buyback is completed. More particularly, each annual report must contain:
 - (i) a summary of the terms of the buyback; and
 - (ii) a statement, as at the date of the annual report, of –
 - the number of voting securities acquired by the Code company under the buyback;
 - the total percentage of the total voting securities on issue that are held or controlled by the exempted person;
 - the total percentage of the total voting securities on issue that are held or controlled in aggregate by the exempted person and the exempted person's associates;
 - the maximum percentage of the total voting securities on issue that could be held or controlled by the exempted person if the maximum number of voting securities were acquired by the Code company under the buyback;
 - the maximum percentage of the total voting securities on issue that could be held or controlled, in aggregate, by the person and the person's associates if the maximum number of voting securities were acquired by the Code company under the buyback; and
- (h) if a buyback is undertaken over a period of more than 12 months and the Code company has a website about itself it must:
 - (i) disclose on its website the information required to be disclosed under paragraph (g); and
 - (ii) announce on its website any aggregate increase of 1% or more in the voting rights held or controlled by the person since the date of last disclosure.

71. It is proposed that the clause 4 class exemption also be amended by inserting a requirement that the notice of meeting in respect of the buyback contains a disclosure of the maximum percentage of all voting securities that could be held or controlled by the exempted person alone, as a result of the buyback.

72. It is proposed that the clause 4 class exemption also be amended by including a condition that there is no effective change in control of the person (if it is a body corporate) until the buyback is completed. However, this condition would not apply if:

- (a) the effective change in control was approved in accordance with rule 7(c) or rule 7(d) of the Code (as the case may be) or permitted under another exemption granted by the Panel; and
- (b) the notice of meeting required by rule 15 or rule 16 of the Code (as the case may be), also contained or was accompanied by the same information as that required to be disclosed under paragraph 70(g) above, in respect of the buyback, stated as at the date of the notice of meeting.

73. It is proposed that the clause 4 class exemption also be amended by including additional terms and conditions that, during the buyback term, the person may only increase their voting control by means other than the buyback (“other increase”), if:

- (a) the other increase was approved in accordance with rule 7(c) or rule 7(d) of the Code (as the case may be) or permitted under another exemption granted by the Panel; and
- (b) the notice of meeting required by rule 15 or rule 16 of the Code (as the case may be) also contained or was accompanied by:
 - (i) a summary of the terms of the buyback that was approved under the exemption; and
 - (ii) a statement, as at the date that was 7 days before the date of the notice of meeting, of –
 - (A) the number of voting securities of the code company that the person holds or controls and the percentage of all voting securities of the code company that that number represents; and
 - (B) the maximum number of voting securities that may be acquired by the code company under the buyback; and
 - (C) the percentage of all voting securities of the code company that the maximum number of voting securities represents; and
 - (D) the maximum percentage of the total voting securities on issue that could be held or controlled by the exempted person after the other increase if the maximum number of voting securities were acquired under the buyback; and
 - (E) the maximum percentage of the total voting securities on issue that could be held or controlled, in aggregate, by the exempted person and the exempted person's associates after the other increase if the maximum number of voting securities were

acquired under the buyback.

(c) for the purposes of sub-paragraphs (B) to (E) above the percentages required to be disclosed must be calculated on the basis that:

- (i) the exempted person's voting control will increase as a result of the other increase and will increase as a result of the buyback; and
- (ii) the exempted person's voting control will increase only as a result of the buyback.

74. It is proposed that the clause 4 class exemption also be amended to provide that where ongoing increases under a buyback, together with the other increase, would result in the maximum percentage of voting securities that could be held or controlled by the person as disclosed in the notice of meeting in respect of the buyback to be exceeded, then the buyback must be approved again by shareholders.

75. It is proposed that the clause 4 class exemption be amended by inserting words to clarify that a person (and that person's associates) is only restricted from voting in favour of the resolution relating to that person's voting control increase. This would clarify that multiple resolutions are permitted.

76. A draft of the clause 4 class exemption containing all of the proposed amendments (including additional proposed definitions for the purposes of the clause 4 class exemption) is set out in Appendix 2.

ANALYSIS OF PREFERRED OPTION

77. The advantages and disadvantages of the preferred option are discussed below. The Panel would be grateful for submissions addressing the extent to which consultees agree or disagree with the analysis. In particular, the Panel would like to know why a consultee disagrees, and what their own analysis would be.

Advantages

78. Under the preferred option each of the 5 identified issues would be resolved. More particularly:

Issue 1 (Changes in ownership of exempted corporates) – this issue would be resolved by making it a condition of the clause 4 class exemption that if there was proposed to be an effective change in the control of a corporate exempted person the details of the exempted person's permitted control increases under the buyback would be disclosed in the notice of meeting sent to the Code company shareholders for deciding whether to approve the effective change of control of the exempted corporate shareholder. As a result, shareholders would be able to make their decision on whether to give their approval on a more fully informed basis;

Issue 2 (Shareholder approval given under "point in time" disclosure) – this issue would be resolved by making it a condition of the clause 4 class

exemption that for buybacks occurring over a period of more than 12 months the details of the exempted person's permitted control increases are disclosed in each annual report of the Code company during the life of the buyback and that any website maintained by the Code company had up-to-date disclosures about the ongoing increases in control of an exempted person for the duration of the buyback. This measure would ensure that the market remains informed of the increase in control of the exempted person that has occurred since the last annual report. The market would also have up-to-date information about the exempted person's on-going increases on a similar basis to the SSH notice regime (in respect of Code companies that run a website). While for listed Code companies this requirement may be able to be met by posting their SSH notices (or, better, a plain English summary of their SSH notices) on their website, for unlisted Code companies this would be a new requirement that would give the market access to more information than is currently available. As a result shareholders of the Code company and investors in the secondary market would be able to make their investment decisions on a more fully informed basis. "Point in time" disclosure would also be enhanced through including the new terms and conditions allowing exempted persons to increase their voting control during the buyback term by means other than under the buyback, subject to obtaining the required shareholder approvals and disclosing the maximum percentage of voting securities which could be held or controlled by the exempted person (and their associates) as a result of the buyback and the other increase. These new terms and conditions would give the clause 4 class exemption a much greater flexibility in respect of exempted persons wishing to increase their voting control during a long term buyback programme otherwise than as a result of the buyback. The disclosure requirements would ensure that shareholders would have all relevant information about potential maximum control increases, for making their decision as to whether or not to approve of the other increase;

Issue 3 (Basis for disclosures not defined) - this issue would be resolved because assumptions such as the date at which the number of shares of the company on issue should be calculated would be defined in the exemption;

Issue 4 (Wording of clause 4(2)(a) unclear) - this issue would be resolved by clarifying that the shareholder approval is for the purposes of the clause 4 class exemption. Thus, market participants wanting to rely on the clause 4 class exemption would have a better understanding of how it operates; and

Issue 5 (Uncertainty over whether multiple resolutions permitted) - this issue would be resolved by clarifying that a person is entitled to vote in favour of a resolution relating to another person's voting control increase and therefore multiple resolutions are permitted.

Issue 6 (Incomplete disclosure of maximum voting control of exempted person) - this issue would be resolved by requiring disclosure of the maximum percentage of all voting securities that could be held or controlled by the exempted person (excluding their associates). This would give an immediate and clear picture to shareholders of the potential control position of the

exempted person (if the buyback is approved). Accordingly, shareholders could make a more fully informed decision.

79. The preferred option meets the Panel's objective of ensuring that the class exemptions relating to buybacks operate effectively and efficiently. It would bring more certainty to applicants as to how the class exemptions apply, while providing for fuller disclosure to better inform shareholders deciding whether or not to approve specific voting control increases, that would otherwise breach the fundamental rule. It would also keep shareholders in the secondary market informed.

Disadvantages

80. Under the preferred option, shareholders relying on the exemption, and the Code company undertaking the buyback, may incur marginally increased compliance costs in relation to the additional information to be included in a notice of meeting for shareholder approval of a change of effective control of a corporate shareholder, or an increased control percentage to be obtained by a shareholder. In addition there would be a marginal increase in costs associated with ongoing disclosures in Annual Reports and of every 1% increase by the exempted person on websites. Unlisted companies do not currently have to make substantial security holder disclosures therefore the compliance costs in relation to the proposed ongoing disclosure requirements would probably be a little greater for them than for listed companies.
81. The Panel considers that the certainties and increased shareholder information resulting from implementing the preferred option significantly outweigh the minor increase in compliance costs that may be incurred.

SUBMISSIONS

82. The Panel welcomes your submissions on this paper. Please see the questionnaire at Appendix 3.

APPENDIX 1

Current wording of the clause 4 class exemption

“CLAUSE 4 EXEMPTION FOR BUYBACK APPROVED BY SHAREHOLDERS

4(1) Every person who increases voting control as a result of the acquisition by a code company of its own voting securities is exempted from rule 6(1) of the Code in respect of that increase in voting control.

4(2) The exemption is subject to the condition that—

(a) the acquisition is approved by an ordinary resolution of the shareholders of the code company; and

(b) neither the person nor any person who is or was at the time an associate of the person voted in favour of the resolution; and

(c) the notice of meeting containing the proposed resolution contained, or was accompanied by,—

(i) the identity of the person; and

(ii) particulars of the voting securities that may be acquired by the code company, including—

(A) the maximum number of voting securities that may be acquired; and

(B) the percentage of all voting securities of the code company that the maximum number of voting securities represents; and

(C) the potential maximum aggregate of the percentages of all voting securities in the code company that the person and the person's associates would hold or control if the maximum number of voting securities were acquired; and

(iii) the consideration for the acquisition or the manner in which the consideration would be determined and when the consideration would be payable; and

(iv) the reasons for the acquisition; and

(v) a statement to the effect that the increase in the person's voting control that would result only from the acquisition by the code company of its own voting securities, if approved, would be permitted as an exception to rule 6 of the Code; and

(vi) a report (or summary of a report) from an independent adviser in relation to the acquisition that complies with rule 18 of the Code (as if the references in that rule to acquisition under rule 7(c) of the Code and notice of meeting referred to in rule 15 of the Code were references to the acquisition and the notice, respectively); and

(vii) a statement by the directors of the code company in relation to the acquisition that complies with rule 19 of the Code (as if the reference in that rule to acquisition under rule 7(c) of the Code was a reference to the acquisition); and

(ca) at the same time that the notice of meeting containing the proposed resolution was sent to shareholders, the code company also sent to the Panel, in hard copy and (if possible) in electronic form, a copy of the notice and any document accompanying it that related to the meeting; and

(cb) at the same time that a person (if any) published or sent to the shareholders, in respect of the meeting, a statement or information that was not required to be published or sent by the rules of the Code, or by this clause as a condition of this exemption, that person also sent to the Panel, in hard copy and (if possible) in electronic form, a copy of that statement or information; and

(d) rules 18 and 19 of the Code are complied with in relation to the proposed acquisition (as if the references in those rules to acquisition under rule 7(c) of the Code and notice of meeting referred to in rule 15 of the Code were references to the acquisition and the notice, respectively)."

APPENDIX 2

Proposed amended wording of the clause 4 class exemption

4 Exemption for buyback approved by shareholders

- (1) Every person who increases voting control as a result of the acquisition by a code company of its own voting securities is exempted from rule 6(1) of the Code in respect of that increase in voting control.
- (2) The exemption is subject to the conditions that—
 - (a) for the purposes of the exemption, the acquisition is approved by an ordinary resolution of the shareholders of the code company; and
 - (b) neither the person nor any person who is or was at the time an associate of the person voted in favour of the resolution relating to the person's voting control increase; and
 - (c) the notice of meeting containing the proposed resolution contained, or was accompanied by,—
 - (i) the identity of the person; and
 - (ii) particulars of the voting securities that may be acquired by the code company, including—
 - (A) the maximum number of voting securities that may be acquired; and
 - (B) the percentage of all voting securities of the code company that the maximum number of voting securities represents; and
 - (C) the potential maximum percentage of all voting securities in the code company that the person would hold or control if the maximum number of voting securities were acquired; and
 - (D) the potential maximum aggregate of the percentages of all voting securities in the code company that the person and the person's associates would hold or control if the maximum number of voting securities were acquired; and
 - (iii) full particulars of the acquisition; and
 - (iv) the consideration for the acquisition or the manner in which the consideration would be determined and when the consideration would be payable; and
 - (v) the reasons for the acquisition; and
 - (vi) a statement to the effect that the increase in the person's voting control that would result only from the acquisition by the code company of its own voting securities, if approved, would be

permitted as an exception to rule 6 of the Code; and

- (vii) a report (or summary of a report) from an independent adviser in relation to the acquisition that complies with rule 18 of the Code (as if the references in that rule to acquisition under rule 7(c) of the Code and notice of meeting referred to in rule 15 of the Code were references to the acquisition and the notice, respectively); and
- (viii) a statement by the directors of the code company in relation to the acquisition that complies with rule 19 of the Code (as if the reference in that rule to acquisition under rule 7(c) of the Code was a reference to the acquisition); and
- (ix) a summary of the terms and conditions of the exemption; and
- (d) the number and percentages required to be disclosed in the notice of meeting under clause 4(2)(c)(ii) were calculated:
 - (i) on the basis of the number of shares of the Code company on issue 7 days before the date of the notice of meeting; and
 - (ii) on the assumption that, other than as a result of the acquisition, there is no change to the total number of voting securities on issue between the date that was 7 days before the date of the notice of meeting and the completion of the acquisition; and
- (e) the notice of meeting containing the proposed resolution displayed, in a prominent position, a disclaimer stating that by exempting the person from rule 6(1) of the Code, the Panel is:
 - (i) neither endorsing nor supporting the accuracy or reliability of the contents of the notice of meeting;
 - (ii) not implying it has a view on the merits of the acquisition by the code company; and
- (f) the form of the notice of meeting containing the proposed resolution was approved by the Panel; and
- (g) at the same time that the notice of meeting containing the proposed resolution was sent to shareholders, the code company also sent to the Panel, in hard copy and (if possible) in electronic form, a copy of the notice and any document accompanying it that related to the meeting; and
- (h) at the same time that a person (if any) published or sent to the shareholders, in respect of the meeting, a statement or information that was not required to be published or sent by the rules of the Code, or by this clause as a condition of this exemption, that person also sent to the Panel, in hard copy and (if possible) in electronic form, a copy of that statement or information; and
- (i) rules 18 and 19 of the Code are complied with in relation to the

proposed acquisition (as if the references in those rules to acquisition under rule 7(c) of the Code and notice of meeting referred to in rule 15 of the Code were references to the acquisition and the notice, respectively); and

- (3) The exemption is subject to the additional condition that there is no effective change in control of the person (if it is a body corporate) during the acquisition term. This condition does not apply if:
 - (a) that effective change in control of the person was approved in accordance with rule 7(c) or rule 7(d) of the Code (as the case may be) or permitted under another exemption granted by the Panel; and
 - (b) the notice of meeting required by rule 15 or rule 16 of the Code (as the case may be) or as a condition of an exemption granted by the Panel contained or was accompanied by the information required to be disclosed under clause 4(4)(a), stated as at the date of the notice of meeting that relates to the effective change of control.
- (4) The exemption is subject to the additional conditions that:
 - (a) if a buyback is undertaken over a period of more than 12 months, every annual report of the code company during the acquisition term includes, in a prominent position and in a form approved by the Panel,
 -
 - (i) a summary of the terms of the acquisition that was approved; and
 - (ii) a statement, as at the date of the annual report, of –
 - (A) the number of voting securities acquired by the code company under the acquisition;
 - (B) the total percentage of the total voting securities on issue that are held or controlled by the person;
 - (C) the total percentage of the total voting securities on issue that are held or controlled, in aggregate, by the person and the person's associates;
 - (D) the maximum percentage of the total voting securities on issue that could be held or controlled by the person if the maximum number of voting securities were acquired by the code company;
 - (E) the maximum percentage of the total voting securities on issue that could be held or controlled, in aggregate, by the person and the person's associates if the maximum number of voting securities were acquired by the code company; and
 - (b) if a buyback is undertaken over a period of more than 12 months and the code company has a website about itself it must, during the

acquisition term:

- (i) disclose on its website the information required to be disclosed under clause 4(4)(a); and
 - (ii) announce on its website any aggregate increase of 1% or more in the voting rights held or controlled by the person since the date of last disclosure under this subclause, or, where no prior disclosure has been made, since the date of the first aggregate increase of 1% or more in the voting rights held or controlled by the person;
 - (iii) the announcement referred to in clause 4(4)(b)(ii) must be made as soon as the code company is aware, or ought to be aware, that the relevant increase has occurred;
- (5) The exemption is subject to the additional terms and conditions that, during the acquisition term, the person may only increase their voting control by a means other than under the acquisition, if the following have first been complied with in relation to the other increase:
- (a) the approval requirements of clause 4(6) and clause 4(7); and
 - (b) the notice of meeting requirements of clause 4(8).
- (6) For the purposes of clause 4(5):
- (a) if the other increase is by an acquisition by the person of voting securities then that acquisition must be approved in accordance with rule 7(c) of the Code or permitted by another exemption granted by the Panel; and
 - (b) if the other increase is by an allotment to the person of voting securities then that allotment must be approved in accordance with rule 7(d) of the Code or permitted by another exemption granted by the Panel.
- (7) For the purposes of clause 4(5), if an other increase would result in the maximum percentage of voting securities that could be held or controlled by the person as disclosed in the notice of meeting in respect of the acquisition approved under clause 4(2)(a) to be exceeded, then the acquisition by the code company of its own voting securities must be approved by an ordinary resolution of the shareholders of the code company as an adjusted acquisition.
- (8) For the purposes of clause 4(5):
- (a) the notice of meeting required by rule 15 or rule 16 of the Code (as the case may be) also contained or was accompanied by:
 - (i) a summary of the terms of the acquisition that was approved under clause 4(2)(a); and
 - (ii) a statement, as at the date that was 7 days before the date of the

notice of meeting containing the proposed resolution for approval of the other increase and the adjusted acquisition for the purposes of clause 4(6) and clause 4(7) respectively, of –

- (A) the number of voting securities of the code company that the person holds or controls and the percentage of all voting securities of the code company that that number represents; and
 - (B) the maximum number of voting securities that may be acquired by the code company under the acquisition; and
 - (C) the percentage of all voting securities of the code company that the maximum number of voting securities represents; and
 - (D) the maximum percentage of the total voting securities on issue that could be held or controlled by the person after the acquisition by the code company of its own voting securities if the maximum number of voting securities were acquired; and
 - (E) the maximum percentage of the total voting securities on issue that could be held or controlled, in aggregate, by the person and the person's associates after the acquisition by the code copy of its own voting securities if the maximum number of voting securities were acquired;
- (9) For the purposes of clauses 4(8)(a)(ii)(B) to 4(8)(a)(ii)(E) the percentages required to be disclosed must be calculated on the basis that:
- (a) the person's voting control will increase as a result of the other increase and will increase as a result of the acquisition; and
 - (a) the person's voting control will increase only as a result of the acquisition.

Proposed definitions (for the purposes of the clause 4 class exemption)

acquisition term, means the period commencing on the date of the meeting for approval of the acquisition under clause 4(2) and ending on the date the company completes the acquisition of its own voting securities;

adjusted acquisition, means an acquisition approved (for the purposes of the exemption) in accordance with clause 4(2), adjusted to include the disclosures required by clause 4(8) and 4(9);

other increase, means an increase in the person's voting control that occurs otherwise than as a result of the acquisition approved under clause 4(2)(a);

APPENDIX 3: QUESTIONNAIRE

Problem definition

A. Do you agree that there is a problem? If you do, do you consider that the discussion document explains the problem adequately? If not please explain your views:

Comment:

Policy objectives

B. Are the stated policy objectives appropriate for assessing the options included in this discussion document?

Comment:

C. Are there other objectives which you think should be included for the assessment of the options discussed, or should some of the objectives used in this discussion document be excluded? Why?

Comment:

D. Are some objectives more important than others? Why?

Comment:

Options

E. Are there any other options you believe the Panel should consider? What are they and why should they be considered?

Comment:

F. Do you agree with the Panel's assessment of the options? If not, what would your assessment be and why?

Comment:

G. What option do you prefer and why?

	YES	NO
Option 1: Take no action		
Option 2: No policy changes but clarify wording of clause 4		
Option 3: Limit the time over which the clause 4 class exemption could be relied upon and clarify wording in clause 4		
Option 4: Revoke the clause 4 class exemption		
Option 5: Amend and clarify wording of clause 4 conditions – mirror exemption conditions for rules 15(b) and 16(b) of Code.		

Comment:
