

Update from the Takeovers Panel 2008

7th annual Mergers & Acquisitions Summit 2008

1. Introduction

Thank you for the opportunity to address you today. My paper is in two parts. The first is a very brief update on current matters. The second is a case study in relation to the recent determinations the Panel made in respect of Kerifresh Limited.

2. Panel Update

Schemes / Amalgamations

In December 2007 the Panel issued a discussion paper on the issue of schemes and amalgamations being used to change the control of code companies. 16 submissions were received from a range of submitters. Most were of good quality and very helpful.

The Panel is considering these submissions next week following which the Panel will be formulating recommendations to the Minister of Commerce on changes to the law. We expect the Ministry will then prepare a discussion document to seek public comment on any proposed changes to the law. Depending on the Ministry's resources this further discussion document should be circulated by July this year.

Truth in Takeovers

On 29 February this year, the misleading conduct provisions affecting Code regulated companies came into force. Rule 64 of the Code regulates misleading or deceptive conduct in relation to Code regulated transactions but importantly, regulates this behaviour which is preliminary or incidental to transactions which are or are likely to be regulated by the Code. This Code rule is supplemented by section 44C of the Takeovers Act which treats as a criminal offence, the making or disseminating of materially misleading statements or information in relation to Code regulated transactions.

The Panel will rigorously enforce the prohibitions against misleading or deceptive conduct. At an operational level, you will find the Panel executive particularly active in relation to "last and final" statements made in relation to takeovers. Statements such as "The Offeror will not be increasing the price" or "The Offeror will not extend the offer period" will be subject to scrutiny by the Panel executive when it comes to their attention and an enquiry as to whether unqualified statements such as these are meant to be qualified is likely to be made. Where a breach of these provisions occurs and the party in breach is not prepared to, or cannot, correct the breach, the Panel is likely to call a meeting under section 32 of the Takeovers Act.

I recommend to you, issue #22 of "Codeword" which was published in December. This issue explains the operation and interpretation of the new rule and the Panel's application of that rule.

Technical Amendments

The Panel is currently processing another round of technical amendments to the Code and the Act to deal with various anomalies and technical difficulties that have come to light since the last round of technical amendments in 2006. One example of such an anomaly is that holders of preference shares, which have no voting rights and are treated as debt securities for accounting purposes, are still considered “shareholders” for the purposes of the “50 or more shareholders” definition of “code company”. As a result, companies, such as some finance companies, which may have only a very small group of ordinary shareholders will be subject to the Code by virtue of the preference shares that they have on issue. The Panel is currently looking at amending definitions in the Act and the Code to address this difficulty.

3. Kerifresh Case Study

Kerifresh is one of those cases which is useful in demonstrating the nuances of the Code, particularly the associate rules, and how the Panel operates both in terms of time and process.

The First Complaint

On 1 October 2007 Turners and Growers Limited (“T&G”) gave notice under rule 41 of the Code of its intention to make a full takeover offer for Kerifresh Limited. On the same date T&G lodged a complaint with the Panel alleging that a number of irregularities had occurred in transactions in Kerifresh shares over the previous 5 years. The initial complaint together with further subsequent complaints resulted in the Panel convening two formal enquiries. These resulted in determinations which found certain parties in breach of the Code.

History

Kerifresh is an unlisted code company incorporated in 1992 by founders Alan Thompson and Peter Hendl. Subsequently further shareholders were introduced through an IPO. A Mr Graham Cowley who was known to Thompson introduced at that time Hamish McHardy as a shareholder.

Share Register 1 July 2001

At 1 July 2001 when the Code came into force, the share register recorded:

- Alan Thompson (and his wife) as the holders of 18.49%
- Peter Hendl (and his wife) as the holders of 17.84%
- Hamish McHardy and separately his son, Jonathan through his family trust, the Murrayfield Trust as the holders between them of less than 1%.

2002 acquisitions by the McHardys

In early 2002, Hendl was a seller of his shares. Cowley acted as an intermediary in the sale between Hendl, McHardy and Thompson (who appeared to have concerns about the effect that such a sale might have on the liquidity of the shares).

On or about 29 May 2002, after a period of negotiation, agreement was reached for the sale of the Hendl parcel. Hamish McHardy acquired 669,200 shares in Kerifresh from the Hendls. In addition Jonathan McHardy and Hamish McHardy, as trustees of the Murrayfield Trust, acquired the balance of the Hendl's holding, being 597,316 Kerifresh shares. The trustees of the Murrayfield Trust already held 20,000 Kerifresh shares for the Trust, and Hamish already held 10,000 Kerifresh shares in his own name. The combined holdings of the McHardys, father and son, in their personal and trustee capacities, was 18.26% of the total voting rights in Kerifresh following these acquisitions in May 2002.

The Warehousing Arrangement

Critically at that point of time, and as a condition of his commitment to acquiring shares, Hamish required Thompson to also make a similar commitment, or as was described to the Panel, "to have some skin in the game" by taking up some of the Hendl shares.

An arrangement was entered into which is described by the Panel as a "warehousing arrangement" under which, in effective terms, Thompson "acquired" an interest in approximately 5% of the Hendl shares. This was characterised as an interest free loan to Hamish McHardy. The terms of the arrangement:

- Required Hamish to hold the economic benefit of the shares for Thompson;
- Repayment on demand; and
- Repayment to be effected by way of a transfer of the shares .

Thompson explained at the first Panel meeting that the reason why the warehousing agreement was implemented was so that Thompson's name would not appear as the purchaser of any of the Hendl shares. The rationale for this was that, for a number of reasons given in evidence at the meeting, they did not want Hendl to know Thompson was a buyer of Hendl shares.

Following this transaction, the relevant holdings were:

- Thompson – Legal 18.49% - Beneficial 23.57%;
- Hamish McHardy – Legal 9.57% - Non-beneficial 5.08%; and
- Jonathan McHardy (Murrayfield Trust) – 8.69%.

Panel Determination – Hamish McHardy/Thompson Association

The Panel determined that Hamish McHardy and Jonathan McHardy were associates for Code purposes in 2002. In addition to their personal relationship as father and son, and their common investment interests, they also, as co-trustees of the

Murrayfield Trust, had an ownership relationship that made them associates for Code purposes.

No Code breach arose from that association. The significance of that association arose in relation to the association with Thompson.

The Panel determined that Hamish McHardy and Alan Thompson were associates by reason of the business relationship which arose under the warehousing arrangement and by virtue of the ownership relationship in respect of the parcel of Kerifresh shares.

Hamish's purchase when aggregated with the voting control of his associates, Thompson and Jonathan therefore exceeded 20%. The Panel found this to breach the Code.

Panel Determination – Jonathan McHardy/Thompson Association

The Panel also found that the nature of the relationship between Thompson, Hamish McHardy and Jonathan McHardy was such that, in the circumstances (being the purchase of the Hendls' Kerifresh shares in 2002) Alan Thompson should be considered to be an associate of Jonathan McHardy for Code purposes at 2002 and at least until the warehousing arrangements were unwound in 2005.

The Murrayfield Trust's acquisition of shares from Hendl increased Jonathan's control of voting rights in excess of 8%. When aggregated with the voting control of his associates, Thompson and Hamish, this exceeded 20%. The Panel found this to breach the Code.

Hamish McHardy transfer to Sundry

In September 2002, Hamish McHardy transferred his shares to his investment vehicle, Sundry Investments Limited. The Panel did not take issues with this "transfer" because the shares remained under the control of Hamish.

The control position and associate relationships as found by the Panel are represented in slide #11, above.

Panel Determination – Sundry 1.18% purchase

However, in 2003, Sundry purchased further shares (1.18%) raising the legal ownership to 10.61%. That purchase, when aggregated with the holdings controlled by associates, Thompson and Jonathan McHardy was in excess of 20%

The Panel determined that these shares were acquired in breach of the Code.

Panel Determination – Cowley – GMSF – Thompson

In the period July 2004 to June 2005, GMS Fulfilment Limited ("GMSF"), a company owned by Cowley acquired 245,000 Kerifresh shares (3.45%) from various shareholders. The Panel found that this was undertaken pursuant to an arrangement

under which Hamish McHardy would provide the funds for the purchases on the understanding that the shares would be transferred to Thompson in due course.

The Panel also found that although Cowley owned GMSF, Thompson controlled the exercise of the voting rights attached to GMSF's Kerifresh shares.

The Panel concluded that GMSF, by virtue of these transactions, was an associate of Thompson and Hamish McHardy. The Panel determined that these shares purchased by GMSF and controlled by Thompson when aggregated with the holdings of these associates exceeded 20% and breached the Code.

Panel Determination – Anbran Transaction

In November 2005, the 245,000 shares held by GMSF were transferred to Anbran Limited – the trustee of the Anbran Trust, established for the benefit of Thompson's children. The sole director and shareholder of Anbran Limited was Emma Eastwood, Thompson's niece.

The shares were transferred for no payment of funds.

In December 2005, Anbran acquired a further 116,000 shares in Kerifresh which were financed by Hamish McHardy.

The shares held by Anbran, funded by Hamish McHardy as set out above totalled 361,000 (5.3%) being the same number which had been the subject of the warehousing arrangement. The Anbran transaction brought that arrangement to an end. The result was an overall increase in the control of voting rights by the McHardy interests of about 5%. Thompson did not increase his voting control except while GMSF held Kerifresh shares.

The Panel found that Anbran was an associate of Thompson, that no Code mechanism had been used for the acquisition of shares, which when aggregated with the Thompson's holding exceeded 20% in breach of the Code.

The Second Complaint

On 19 October 2007 the Panel received a further complaint from T&G relating to an offer for 335,000 Kerifresh shares made by a Mr Lawrence Fletcher on 18 October 2007 (made after the T&G Takeover Notice) and circulated to Kerifresh shareholders by the Auckland law firm of Grove Darlow & Partners ("Grove Darlow").

T&G alleged that Grove Darlow was acting for Hamish McHardy and that Lawrence Fletcher was linked with Hamish McHardy and his son Jonathan McHardy in ways which suggested that they were associates for the purposes of the Code. If that were the case then the offer by Lawrence Fletcher would not comply with the Code because of the percentage of voting rights in Kerifresh already held or controlled or which would be held or controlled by the three of them in aggregate.

The Relationship – McHardy's/Fletcher

Fletcher was a work colleague and friend of Jonathan McHardy. Fletcher had made a previous property investment in New Zealand with Hamish and Jonathan McHardy. On the liquidation of that investment, Fletcher lent his share of the funds at the suggestion of Jonathan to the Murrayfield Trust.

In August, preceding his 18 October offer, Fletcher had made an initial investment of 10,000 Kerifresh Shares through the nominee company of Grove Darlow, GDP Trustee Limited. He told the Panel that he had invested in Kerifresh at the recommendation of Jonathan. That purchase was facilitated by Hamish McHardy who paid for the shares and was reimbursed by funds released by Jonathan McHardy to Lawrence Fletcher in part repayment of the loan by Fletcher to the Murrayfield Trust.

That initial purchase by itself, even if there was an associate relationship as alleged in the complaint, had no code consequence as the holdings did not exceed 20% in aggregate. However, if an associate relationship did exist, the 18 October offer for 335,000 shares (4.42%) would represent a breach of the Code. It became apparent that the intention was to acquire an additional 165,000 shares (2.18%) from Thompson taking the total to 500,000 shares (6.60%).

The Panel found that Fletcher, Hamish McHardy and Jonathan McHardy had an understanding between them that their purpose was to get Lawrence Fletcher to become the holder or controller of an increased percentage of voting rights in Kerifresh by initially acquiring 10,000 shares in Kerifresh and by subsequently increasing his holding to up to 500,000 Kerifresh shares through his offer to shareholders (and his agreement with Thompson).

Panel Determination – Fletcher an Associate of the McHardy’s

The Panel concluded that Lawrence Fletcher, Hamish McHardy and Jonathan McHardy were associates (in terms of rule 4, this conclusion was reached on the basis that they had acted in concert in relation to Lawrence Fletcher becoming the holder or controller of an increased percentage of voting rights in Kerifresh, and that they had a personal or business relationship such that, under the circumstances (being the offer to acquire voting rights in Kerifresh by Lawrence Fletcher) they should be considered as associates for the purposes of the Code.)

The proposed purchase of shares by Fletcher then, when aggregated with the shares of his associates, would exceed 20% in breach of the Code.

Panel Process & Timing

The non-compliance with the Code first came to the Panel’s attention through complaints made by potential takeover suitor T&G. A quick summary of the Panel’s enforcement procedure in relation to Kerifresh follows:

First Complaint

- On Monday, 1 October 2007: T&G sent out a takeover notice announcing its intention to make a full offer for Kerifresh at \$2.00 a share. The same day T&G made its first complaint to the Panel.
- On Wednesday, 10 October 2007: After having made further inquiries, the Panel decided to call a section 32 meeting. It also made temporary restraining orders prohibiting those persons alleged to have breached the Code from acquiring, disposing or voting Kerifresh shares. Those restraining orders were to expire on the close of 18 October 2007.
- On Tuesday 16 October 2007: The Panel held its first section 32 meeting.
- On Thursday 18 October 2007: The Panel published its determinations and statements of reasons. Having found various persons in breach of the Code the Panel continued the temporary restraining orders restraining those persons from acquiring, disposing or voting Kerifresh shares for a further 21 days.

Second Complaint

- On Friday 19 October 2007, the Panel received T&G's second complaint.
- On Tuesday 30 October 2007: After having made its own inquiries, the Panel decided to hold another section 32 meeting to consider this further complaint. It also made temporary restraining orders prohibiting those person alleged to have breached the Code from acquiring, disposing or voting Kerifresh shares. Those restraining orders were to expire on the close of 9 November 2007.
- On Wednesday 7 November 2007: The Panel held the second section 32 meeting.
- On Friday 9 November 2007: The Panel published its determinations. Having found various persons in breach of the Code the Panel continued the temporary restraining orders restraining those persons from acquiring, disposing or voting Kerifresh shares for a further 21 days.
- On Thursday 22 November 2007: The Panel published its statement of reasons.

Remedial Action - Options

Once the Panel finds a breach, the question becomes “what is the appropriate remedial action?” The Panel has no power to order any particular remedy or to impose penalties. Following a determination its only power is to order a restraining order for up to 21 days and may apply to the Courts for a remedy or penalty.

In some cases, the Panel finds that there is no need to take any formal action. This may be simply because the effect of a restraining order issued at the time of the determination means that the person in breach can no longer comply with the timing constraints imposed by the Code. For example, this could happen where the Panel has determined that the terms of an offer accompanying a Takeover Notice could result in

a breach of the Code when the offer is made. In this example, the Takeover Notice would simply be stale and the offeror in breach would need to restart the process.

In those cases where the remedy is not this simple, at a practical level, the Panel is usually faced with two formal options:

- Negotiate and agree a commercial solution with the parties, such solution being supported by enforceable undertakings under section 31T of the Act and/or;
- Apply to Court for the imposition of orders.

The approach taken will depend on the facts and circumstances of the case.

When considering which option to take the Panel may consider that the effect of some of the Court orders can be approximated by enforceable undertaking. However, there are some remedies that only the Court can order, for example, forfeiture or the unilateral cancellation of contracts.

Remedies – General Principles

A negotiated sell-down of the shares acquired in breach is the Panel's most common remedial solution. Sell-down is consistent with the Code's concern with regulating the acquisition of voting rights that could affect the control of code companies.

This process has a number of advantages over a Court imposed order. It avoids the cost, inconvenience and delay of Court proceedings. It therefore ensures that the control situation of a company is resolved quickly, without disproportionate cost to shareholders. It also avoids the control uncertainties which arise from the protracted time which often accompanies Court sought remedies. The conditions which the Panel imposes in these cases include:

- That the sale is to non-associates;
- Pending sale the voting rights attached to the shares in breach are not exercised;
- A fixed timeframe for sale.

The Panel will have recourse to the Courts if a negotiated solution such as a sell-down cannot be agreed. As a matter of principle, the Panel considers that it should seek remedies from the Courts which are of a penal nature such as forfeiture in those cases where a person has deliberately acquired shares in breach of the Code. Although, this approach has not yet been tested in the Courts.

Application to Kerifresh

In the Kerifresh matter, the Panel did not find any deliberate breaches of the Code. For that reason, after consultation with the interested parties, the Panel considered that a sell-down was the most appropriate remedy. Influential to the Panel's thinking, especially given the alternative of seeking Court remedies, was:

- A takeover offer for the company was imminent;

- The cost of Court action to Kerifresh, a relatively small company, would disproportionately and adversely impact on shareholder value;
- Court proceedings would leave Kerifresh in an uncertain control position for an unacceptably long time;
- The general policy of the Panel.

However, there were some potential practical problems with sell-down. The market for Kerifresh shares was highly illiquid. Less than 5% of Kerifresh was traded in 2007. By contrast, about 21% was acquired in breach and would need to be sold down. The Panel was able to balance that difficulty against the fact that more than one party was willing to make a takeover offer for the company.

It was agreed with the parties in breach that the shares acquired in breach would be transferred to an independent trustee for sale by open auction. This would result in a transparent contest for control of the company, in which all shareholders could participate.

The parties in breach did not accept the findings of the Panel. However, they agreed to the independent trustee/auction process on the basis that it was recorded that they did not accept the Panel's findings.

Auction Process

The Panel appointed ABN AMRO Craigs Limited as an independent trustee for the sell-down to whom the shares in breach were to be transferred. The independent trustee was to be under a general duty to get the best price for the shares transferred. The independent trustee could also accept lock-up agreements in respect of some or all of the 21% acquired in breach. If the agreement was made with a third party, the sale terms would require a full takeover offer, otherwise that acquisition would result in non-compliance with the code. If the agreement was with one of the persons in breach, the sale terms were to provide that the full takeover offer must be made subject a 50% minimum acceptance condition.

Additionally, the auction was open. Any person could register to be a bidder. All registered persons would be sent all details of bids, other than the identity of the bidder, as those bids were received.

A further rule, covered by undertaking, was that if a person whom the Panel had found in breach acquired shares via the auction then that person had to make a full cash takeover offer at the higher of the price paid in the auction and \$2.00. This meant that a person in breach essentially had two options:

- Do nothing and have their shares sold by the independent trustee;
- Alternatively, make a full cash takeover offer.

The cash takeover offer option was appropriate because it was one way in which that person (given the associate relationships found by the Panel) could have complied with the Code at the time of the original acquisitions.

Kerifresh Remedy – Timing

The parties agreed to the proposals on 19 December 2007 and their shares were transferred to ABN AMRO Craigs on 23 December 2007. ABN AMRO Craigs were appointed independent trustee after approaches to a number of professional brokerage firms.

The auction opened on Friday 18 January 2008 and closed on Wednesday 23 January 2008.

T&G won the auction with a lock-up to make a full cash offer at \$2.10 per share, with a 50% minimum acceptance condition.

Conclusions on the Remedy

The Panel considered that the agreed procedure was the best solution available:

- It was timely;
- It was cost efficient;
- It provided a platform for a transparent change in control of Kerifresh in a competitive environment; and
- Small Kerifresh shareholders were being provided with an exit from an illiquid security at a competitive market price;

4. Closing

In closing I would like to remind you that the Panel Executive is there to assist you with any questions you may have in practice and that the Panel website is a comprehensive resource.

D. O. Jones