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## Takeovers Code permits lock-up agreements

Lock-up agreements are permitted by the Code and the policies that underpin it. These include lock-up agreements which occur before a bid is made (pre-bid lock-ups) and agreements made during the offer process (intra-bid lock-ups).

### PRE-BID LOCK-UPS

A pre-bid lock-up agreement is an agreement between a shareholder and a potential bidder that if the bidder makes a takeover offer for the company on agreed terms then the shareholder will accept that bid.

There is no doubt that such an agreement is permitted by the Code. The fundamental rule contained in rule 6(1) deals with increases in the holding or controlling of voting rights in a code company. Consequently, if the pre-bid agreement does not have the effect that the potential bidder becomes the holder or controller of the voting rights attaching to the shares then no breach will occur.

Clause 8 of Schedule 1 of the Code recognises this position. Under this clause all that is required is that in the offer the bidder must give details of any party that has agreed conditionally or unconditionally to accept the offer and the material terms of the agreement.

Acceptance of the legality of pre-bid agreements is not an oversight in the Code but flows directly from the way the Code

has been constructed. The key provisions controlling the content of pre-bid contracts are the fundamental rule as mentioned above, and also rule 20 which requires that an offer must be made on the same terms and provide the same consideration for all securities of the same class. The same rule has the effect also of preventing collateral arrangements which are intended to enhance the effective price received by a shareholder.

It has been suggested that a loophole exists because a party can obtain a number of pre-bid agreements and hence at the time the offer is made the bidder may be in a strong position to achieve a successful outcome. In addition of course, the bidder can acquire outright up to 20% of the voting rights of the target company before a bid is made.

The Code deals with this situation in a number of ways. First, the potential bidder may not actually acquire and control more than 20% of the voting rights in the target company. Second, rule 23 of the Code requires that the bid be conditional upon the bidder obtaining control over more than 50% of the voting rights in the target company. Third, as mentioned above, under rule 20 the offer must be made on the same terms and conditions to all holders of securities of the same class. Furthermore, it can be expected that parties to pre-bid agreements will want to achieve the best possible price for their shares.

If the bid proceeds and is successful the Code will have achieved the desired outcome. The process will be conducted in accordance with the provisions of the Code, including the obligation to provide independent advice, so that all shareholders will be fully informed. Pre-bid agreements may have contributed to the success of the bid, but is this a criticism?

In formulating the Code, the Panel was required by the terms of the Takeovers Act 1993 to consider a number of objectives. These objectives include:

- encouraging the efficient allocation of resources;
- encouraging competition for control of companies; and
- assisting in ensuring the fair treatment of shareholders.

Fair treatment of shareholders, which the Panel has equated with equal treatment of shareholders, is a fundamental objective of the Code.

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## How the Code applies to lock-up agreements - continued from page 1

This objective is always satisfied in the case of a pre-bid lock-up agreement because other shareholders must be offered the same price as that provided for in the lock-up agreement.

The only issue which needs to be addressed is whether the potential for pre-bid contracts to limit the development of an auction between competing bidders is desirable.

There are good reasons for the Code's approach in allowing pre-bid agreements. This is the subject of considerable discussion in Australia as it considers whether it should move from its present takeovers code to a mandatory bid code, more in line with the City of London code.

The Australian code focuses much more directly on the auction principle. In broad terms, pre-bid agreements are not permitted as they may inhibit the auction between competing bidders. However, this does have important consequences in the operation of the takeovers market.

An example of the flexibility that exists under the New Zealand Code was the sale by the controlling shareholder of its stake in United Networks to Vector. In effect, the seller and the company in conjunction with their financial advisers undertook a competitive process to achieve the best price for the controlling shareholder. This was possible because under the New Zealand Code the preferred bidder had the certainty through a pre-bid agreement with the seller that when the formal bid was ultimately made to all shareholders the controlling shareholder would sell into that bid. Equal treatment was achieved in that all shareholders received that same price. It is argued by many in the commercial world that the ability to undertake a commercial auction in this manner is efficient and also achieves the best outcome.

It is the inability under the Australian code to undertake the same process that has led to pressure to adopt the mandatory bid system. Under this system there would be no constraints whatsoever in undertaking the commercial auction to find the highest bidder for the controlling shareholder's stake in the target company. In fact, a pre-bid agreement is not necessary as there is no restriction on a sale contract being entered into and completed. All that is necessary is for the bidder to subsequently make an offer to all remaining shareholders on the same terms and conditions. This is why the mandatory bid system is often referred to as being based on an exit principle whereby shareholders must be given the opportunity to exit the company, once the threshold has been passed, on terms no less favourable than those enjoyed by the initial sellers.

It can be seen from the above that strict adherence to the auction principle can inhibit commercial transactions which many would regard as efficient business practice. The approach to the New Zealand Code was to try to restrict as far as possible regulation inhibiting normal commercial activity except where

this was necessary to ensure that the fundamental policy objectives of the Code were fulfilled. The United Networks takeover is a good example of the flexibility of the New Zealand Code and the balance achieved between its various objectives.

### INTRA-BID LOCK-UPS

The issue has also arisen recently as to whether during a bid a lock-up agreement can be entered into whereby a shareholder agrees that it will accept the offer as soon as the price has been increased to an agreed figure. Such an agreement is permitted by the Code subject to similar constraints that apply to pre-bid agreements. Just as the original bid must first be made before it can be accepted, so with a variation the variation must first take place in accordance with the provisions of the Code before the offer as varied can be accepted. Rule 20 requiring equal treatment ensures that all shareholders will receive the same price. It is not possible for the "pre-variation" agreement to actually effect a variation as this will result in the bid being varied in a manner which does not comply with the Code. This was the issue that arose in the Otago Power case. The only exception is where the purchase complies with the requirements of rule 36 which is most likely to arise when an offer has become unconditional. Rule 37 then deals with the variation of the offer that flows from any such acquisition at a price in excess of the price contained in the offer.

The important point with lock-up agreements is that the terms must be constrained to ensure that they do not breach the fundamental rule contained in rule 6(1) or rule 20 requiring equal treatment of all shareholders.

## Policy issues

### EXEMPTIONS FOR SCHEMES OF ARRANGEMENT

Last year the Panel formulated a policy on exemptions for schemes of arrangement effected under the Companies Act 1993. The policy explains the circumstances in which applications for exemption for these schemes are likely to be declined and circumstances where the Panel may grant an exemption.

#### Applications for exemption likely to be declined

If an exemption application relates to a scheme of arrangement that is for all intents and purposes a takeover, particularly if it involves expulsion of minorities, the Panel will treat the transaction as a takeover when it considers the application. The Panel is likely to decline such an application so that target company shareholders are not denied the benefit of the full protections of the Code.

#### Circumstances where exemption may be approved

An exemption to facilitate the use of a scheme of arrangement may be appropriate where there are clear and compelling reasons why the proposed transaction should not be structured as a takeover, or completed using one of the mechanisms permitted under the Code.

Applicants for an exemption must provide strong arguments as to why it is proposed to use a scheme of arrangement rather than using the Code. There must be genuine reasons for using a scheme for the Panel to favourably consider granting an exemption. The Panel needs to be satisfied that the scheme is not being promoted in order to avoid the disciplines and protections of the Code.

Any exemption granted by the Panel would be framed so as to preserve as far as possible the objectives of the Code and the disciplines of a Code offer.

The Panel may require as a condition of exemption certain voting thresholds for shareholder approval of the proposed scheme. Generally the following voting thresholds applied as conditions of exemption would be:

- 75% of votes cast by those entitled to vote and who vote at the meeting, including by proxy, and being more than 50% of the total voting rights of the target company; and
- 50% by number of shareholders who are entitled to vote, and who vote at the meeting, including by proxy.

However there may be circumstances where the Panel imposes different, more appropriate, voting thresholds.

The Panel will be concerned to ensure that shareholders are given adequate information about the proposed transaction. It will require, at least, that:

- information provided to shareholders should be equivalent to that which would have been provided under a Code offer; and
- an independent adviser approved by the Panel should report on the merits of the scheme of arrangement to shareholders of the scheme company who are entitled to vote on the proposal.

Applicants for exemption should indicate their intentions in respect of the proposed transaction to the Panel early in the planning process. The exemption application should be sent to the Panel for consideration well before the application to approve the scheme is made to the Court.

The full policy statement can be viewed on the Panel's website [www.takeovers.govt.nz](http://www.takeovers.govt.nz).

## SCRIP OFFERS

Scrip offers can provide difficulties for a bidder in two areas. First, small shareholders may receive unmarketable parcels of scrip. Second, overseas shareholders may necessitate compliance with the requirements of overseas jurisdictions. The Panel has considered both issues.

### Unmarketable parcels – class exemption (2003/234)

Rule 20 of the Code requires an offer to be made on the same terms and provide the same consideration for all securities of the same class. The effect is that an offeror who makes a takeover offer with consideration that includes securities listed on a stock exchange may be obliged to provide some smaller security

holders with an unmarketable parcel of securities. Unmarketable parcels of securities may be difficult for security holders to deal with and are expensive for companies to administer.

Consequently the Panel has granted a class exemption to allow offerors to limit the consideration offered to small security holders to cash.

The expression “small security holder” referred to in the exemption is defined as a person who would, if that person was offered, and accepted, consideration securities under a scrip offer, receive an unmarketable parcel of consideration securities. The other key definition is the “unmarketable parcel” which is defined as a number of consideration securities that is less than the minimum holding of consideration securities specified by the stock exchange.

This class exemption obviates the need for specific exemptions in cases where scrip consideration may result in the issue of unmarketable parcels of shares.

The exemption specifies the way in which the cash consideration which is to replace the scrip consideration is to be calculated. It provides:

- if the offer does not include a cash alternative, the cash consideration is an amount equal to the value of the shares, plus any additional cash under the offer; and
- if the offer does include a cash alternative, the cash consideration is the greater of-
  - o the amount of the cash alternative; and
  - o an amount equivalent to the value of the shares, plus any additional cash under the offer.

The “value of the shares” offered as scrip is defined as the weighted average of the closing prices of the shares on the exchange over a period of five trading days immediately preceding a date which is five days before the first date when consideration is sent to any offeree who has accepted the offer.

### Overseas shareholders

Bidders wishing to offer scrip under a takeover offer will need to ensure that the offer complies with securities laws in every country where target company security holders reside.

The Panel is aware that compliance with securities law requirements in overseas jurisdictions can be expensive and time consuming for bidders. Most jurisdictions have rules or regulations governing the offer of scrip under a takeover offer and many jurisdictions impose prospectus-type requirements in respect of such offers. Compliance with such overseas requirements as well as New Zealand securities law requirements increases the cost and complexity of making a scrip offer for a New Zealand code company.

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### Scrip Offers – continued from page 3

Since the introduction of the Code the Panel has granted two individual exemptions from rule 20 to address difficulties created by the offer of scrip to overseas shareholders. Each exemption in effect allowed the bidder to offer cash rather than scrip to certain overseas shareholders. The exemptions were granted in respect of:

- Normandy NFM Limited's offer for Otter Gold Mines Limited. Normandy proposed to offer scrip as consideration for the Otter shares. The vast majority of its shareholders lived in New Zealand and Australia, and Normandy could offer scrip to those shareholders using the New Zealand takeover documentation and its Australian prospectus. However, shareholders in other jurisdictions held approximately 1.22% of the shares in Otter;
- Independent Newspapers Limited's offer for all of the shares in Sky Network Television Limited. The consideration offered had both a scrip and a cash component. INL's offer could be made in New Zealand, Australia, the United Kingdom and the United States using the New Zealand offer documents. However, approximately 25 Sky shareholders, together holding less than 1% of the shares in Sky, were resident in other jurisdictions.

In both cases the bidders intended to offer scrip in jurisdictions in which New Zealand disclosure documents could be used. However, the bidders stated that because of the small number of shareholders resident in other jurisdictions it was not practical or cost effective to ensure that the scrip offer complied with securities laws in those other jurisdictions. Both bidders proposed to use a nominee arrangement to convert the scrip into cash which would be passed on to the overseas shareholders and sought an exemption from rule 20 to allow them to offer this alternative consideration.

The policy of rule 20 is to ensure that there is equal treatment of all security holders of a code company and the Panel is reluctant to grant exemptions which would allow offers to be made to certain shareholders on different terms. However, the Panel recognises that it is important that the making of scrip offers be a real and practical option available to bidders under the Code. In addition a proper relationship needs to be maintained between the cost of compliance with the Code and the benefits resulting from it.

The Panel granted exemptions from rule 20 to Normandy and INL which in effect allowed cash to be offered to certain overseas shareholders because in both cases the Panel was satisfied that the number of shares held by shareholders in the relevant jurisdictions was of such a low level that compliance with the securities law requirements in those jurisdictions would have been impractical and unreasonably expensive in the context of the offer.

In addition the Panel was satisfied that the alternative consideration to be offered to overseas shareholders was

appropriate. Overseas shareholders were offered the equivalent market value (less reasonable expenses) of the scrip offered to remaining shareholders. This was intended to put the overseas shareholders in the same position as shareholders who receive and immediately sell the scrip offered by the bidder. The market value of the scrip offered by Normandy and INL was relatively easy to establish as in each case it was listed on a recognised exchange.

The Panel recognises that the type of difficulties faced by INL and Normandy may arise in respect of future scrip takeover offers. Most code companies of any size will have shareholders resident overseas. Accordingly, the Panel considers that it is appropriate to indicate when it would be likely to grant specific exemptions from rule 20 to allow cash to be offered to certain overseas shareholders. In general the Panel will grant such an exemption if it is satisfied that, in respect of each jurisdiction in respect of which an exemption is sought:

- the number of target company securities held by shareholders in that jurisdiction is a small percentage of the total issued securities;
- the scrip offer cannot be made using the New Zealand takeover offer, investment statement and/or prospectus; and
- compliance with securities laws in that jurisdiction would be impractical or unreasonably expensive in the context of the offer.

In addition, the Panel would only be likely to grant an exemption from rule 20 if it considers that the alternative consideration to be offered to overseas shareholders is appropriate. The alternative consideration offered should be cash equal to the value of the scrip. As previously noted, this is easier to establish when the scrip is listed on a recognised exchange. If the scrip is unlisted, and a market value is not available, an independent valuation of the scrip offered may be required. Each case will be treated on its merits.

Bidders intending to make scrip offers who wish to apply for an exemption from rule 20 to allow cash to be offered to overseas shareholders should provide evidence that the above criteria is satisfied in respect of each jurisdiction in which code company shareholders are resident and for which exemption is sought. This will require a bidder to make inquiries in each such jurisdiction.

A number of jurisdictions recognise the difficulties facing bidders offering scrip in other jurisdictions. Consequently, in the interests of shareholders resident within their jurisdictions, they have established practical and cost effective procedures to enable scrip offers to be extended to those shareholders.

There is a perception that obtaining advice in respect of the requirements of overseas jurisdictions is prohibitively expensive. This is not always the case. Seeking information regarding overseas requirements does not always require the bidder to instruct overseas advisers. Information can sometimes be obtained from overseas regulators at little or no cost. However,

the Panel does recognise that differences in language and culture may make it difficult to obtain the relevant information. In such cases, if the applicant is able to demonstrate such difficulties, the number of shareholders resident in that jurisdiction is extremely small and the relevant jurisdiction is not one of those in which it is common for shareholders in New Zealand code companies to reside, the Panel may be willing to consider an application without evidence of the cost of compliance with the requirements in that jurisdiction.

#### FEES FOR SECTION 32 MEETINGS – POLICY FOR MEETINGS REQUESTED BY THIRD PARTIES

Section 32 of the Act is the primary section under which the Panel takes enforcement action for possible breaches of the Code. The Takeovers (Fees) Regulations 2001 provide the legislative basis for the Panel to recover some of its costs of holding such meetings in certain circumstances.

Section 32 meetings can be held by the Panel on its own initiative and also at the request of third parties. For example, a target company may ask the Panel to call a meeting under section 32 to investigate some action taken or about to be taken by an offeror in a current takeover.

Under section 35(3) of the Act, where a request is made to the Panel to hold a section 32 meeting and the Panel has not, within 14 days of receiving the request, made a determination, then various parties can apply directly to the Court for orders. The Court can make orders if it is satisfied that a person has not acted or is not acting or intends not to act in compliance with the Code.

Although the Panel is not compelled to hold a meeting when requested to do so it can be expected to convene a meeting unless the request is clearly frivolous or vexatious. Parties applying to the Panel to hold a meeting under section 32 should be aware that if the Panel decides that the person who was the subject of the meeting has acted, or is acting, or intends to act in compliance with the Code, then the person who requested the meeting would normally be expected to meet the full fees and costs of that meeting (at the rates prescribed in the Fees Regulations).

The Panel's Administrative Guidelines for administering these regulations are set out in full on the Panel's website.

## Recent cases

### RICHMOND/PPCS – CLASS EXEMPTION

This exemption arose as a result of orders made by the High Court in respect of proceedings brought against PPCS Limited concerning two parcels of Richmond Limited shares held by PPCS.

The High Court in November 2002 had ordered that one of the parcels be forfeited and that the voting rights attaching to the other parcel be suspended until such time as PPCS sold that parcel. The forfeiture and suspension meant that the voting rights attaching to the shares would not be "currently exercisable" and would therefore not constitute voting rights for the purposes of the Code. Accordingly, the percentage of voting rights held by remaining shareholders would increase proportionately when the orders took effect. This could result in the voting rights of a Richmond shareholder, which had legitimately acquired up to 20% of the voting rights in Richmond before the orders came into force, increasing beyond the 20% threshold in breach of rule 6(1) of the Code.

The orders did not have immediate effect because of an appeal to the Court of Appeal. Subsequently, in January 2003 PPCS made a full takeover bid for Richmond.

The High Court's decision created a number of difficulties for the market. First, there was the uncertainty as to whether the forfeiture and suspension would take effect in view of the appeal.

Second, if the forfeiture and suspension did take effect, then the suspension itself created a very unsatisfactory position under the Code. A shareholder holding 20% of the voting rights in Richmond would, as a result of the suspension, suddenly find itself in excess of the 20% threshold with a result that a sell down to 20% would be required. However, the suspension was not permanent and would cease once PPCS sold the parcel of shares in question. Consequently the shareholder which had originally held 20% of the voting rights but had been forced to sell down shares to comply with the Code would, on the cessation of the suspension, find itself below its original holding of 20%.

In view of the uncertainty as to whether the Court's decision would be upheld on appeal, the Panel considered that the status quo should prevail and shareholders should be entitled to buy and sell shares on that basis. Furthermore, shareholders should not be prejudiced by so doing. Consequently, in the event that the High Court's forfeiture and suspension orders took effect and, as a result solely of the Court orders, a shareholder's voting rights were to exceed the 20% threshold contained in the Code, then there should be an exemption from the Code to allow that excess to be retained. Such an exemption was further justified by the fact that the suspension would eventually cease thereby reducing the amount by which the 20% threshold would be exceeded. The parcel of shares subject to the suspension was over twice the size of the parcel subject to forfeiture.

The Court of Appeal ultimately upheld the forfeiture but quashed the suspension. No shareholder exceeded the 20% threshold as a result of the forfeiture and hence the exemption was not in fact needed.

Although the Richmond exemption is unusual, arising out of a very complex situation, it is an example of the need for the Panel to be proactive in trying to ensure certainty in the operation of the takeovers market under the Code.

## DOMINION RETAIL / TRI-CITY – MISLEADING OFFER DOCUMENT

During December 2003 the Panel determined that a mistake in an offer document, which made the statement of the offer price ambiguous, was a breach of the Code. The Panel also determined how this mistake should be remedied in a pragmatic and efficient manner. This was the first occasion on which the Panel had to consider whether offer documents which contain errors or misstatements relating to the terms and conditions of the offer comply with the Code. The matter was determined at a meeting held under section 32 of the Act to consider whether Dominion Retail Property Fund Limited had complied with the Code in relation to its offer for Tri-City Properties Limited.

Dominion Retail made a takeover offer for all of the parcels of shares and mortgage bonds issued by Tri-City on 2 December 2003. The offer stated that it would expire on 31 December 2003. The offer document stated that anyone accepting the offer would receive \$4750 for each parcel of shares and bonds plus an “additional cash amount”. In relation to the additional cash amount the offer document stated that:

- the additional cash amount would be equal to the amount of interest accrued but unpaid in respect of the bond on the later of 31 December 2003 or the date on which the acceptance was received; and
- for acceptances received on or prior to 31 December 2003 the additional cash amount would be \$475.

However, these two statements were inconsistent. Under the terms of the mortgage bonds the amount of interest that would have been accrued but unpaid on 31 December 2003 was \$118.75 not \$475.

On 5 December 2003 Dominion Retail sent a letter to Tri-City security holders advising that the additional cash amount stated in the offer document was incorrect and that the additional cash amount payable in respect of acceptances received on or prior to 31 December 2003 would be \$118.75 and not \$475.

Following correspondence with Dominion Retail and Tri-City the Panel decided that the mistake in Dominion Retail’s offer raised two issues:

- whether the statement of consideration in the offer complied with the requirements of the Code; and
- whether Dominion Retail could correct the mistake in its offer in a way that complied with the Code.

Clause 5 of Schedule 1 to the Code requires that a takeover offer must contain “all the terms and conditions of the offer”. As consideration is a fundamental term of any contract, an offer document must state the consideration offered in terms such that offerees can understand the amount that will be paid to them should they decide to accept the offer.

The Panel considered that the inconsistencies between the two statements relating to the additional cash amount created a level of uncertainty such that security holders may not have understood the amount of consideration payable to them should they accept the offer on or prior to 31 December 2003. Although the reference to a payment of \$475 for accrued interest to 31 December 2003 was a mistake, it was misleading and confusing. Accordingly, the Panel considered that Dominion Retail’s offer document did not correctly state all of the terms and conditions of the offer as required by clause 5 of Schedule 1 to the Code. The Panel determined that Dominion Retail had breached the Code. If a takeover offer does not correctly state all of the terms and conditions of that offer, it does not comply with the Code.

The Panel also determined that although Dominion Retail had attempted to correct the mistake by subsequently writing to security holders, that letter had no status under the Code. The letter did not constitute a variation of the offer and did not correct the defect in the offer document.

In considering what remedy might be appropriate the Panel did not consider that it would be in the interests of Dominion Retail or Tri-City security holders for the offer to be withdrawn and a new offer made. This would have been time consuming and costly.

The Panel considered that the most practical solution would be for the terms of the offer to be clarified and for all security holders who had accepted the offer to be given the right to withdraw their acceptances. This would in effect put shareholders in the same position they would have been in had Dominion Retail’s offer contained all of the information required by the Code. In order to give security holders the opportunity to consider the offer as clarified the Panel considered that it would be necessary for the offer to be extended beyond the initial expiry date of 31 December 2003.

The Panel decided that it would accept an undertaking from Dominion Retail under section 31T of the Act, that Dominion Retail would:

- extend the period of its offer to 30 January 2004;
- give all security holders of Tri-City who accepted the offer prior to receipt of notification of the Panel’s determination the right to revoke that acceptance at any time up to the closure of Dominion Retail’s offer; and
- send immediately to all security holders of Tri-City a letter to be approved by the Panel explaining the correct terms of the offer, the rights of security holders to revoke their acceptance, and related matters.

Such an undertaking was provided before the Panel released its determination. A letter clarifying the terms of the offer and advising security holders of their right to withdraw their acceptances was sent to security holders on 19 December 2003. The Panel has been advised that a small number of security holders withdrew their acceptances.

## CEDENCO / SK FOODS – COMPULSORY ACQUISITION EXEMPTION

In August 2003 SK Foods International made a takeover offer for all the shares in Cedenco Foods Limited that it did not own. The takeover offer was successful and on 10 September 2003 SK Foods became the dominant owner of Cedenco.

Under rule 54 a dominant owner must issue an acquisition notice to all outstanding shareholders within 30 days of becoming dominant owner. SK Foods issued its acquisition notice the next day, 11 September 2003, while its takeover offer was still open.

In that notice SK Foods said that it would pay \$2.30 for all outstanding shares in Cedenco (the same as its offer price) and informed shareholders that they had no right to object to the compulsory acquisition price.

An issue arose for the Panel because SK Foods was not entitled to assert that outstanding Cedenco shareholders had no right to object to the compulsory acquisition price of \$2.30.

SK Foods was relying on rules 56(1) and 56(2) of the Code. These require a person who becomes the dominant owner through acceptances of an offer to pay the same consideration for compulsory acquisition provided it has received acceptances for more than 50% of the shares that were the subject of the offer.

In these circumstances the outstanding shareholders have no right to object to the acquisition price and the offeror has no choice as to the consideration it will pay.

If, however, an offeror achieves dominant ownership otherwise than under an offer, or where it has not received acceptances for more than 50% of the shares that were the subject of an offer, then it must pay consideration that has been certified as fair and reasonable by an independent adviser. In such a case the outstanding shareholders have the right to object to that price. If sufficient shareholders object then the matter must go to expert determination by an expert appointed by the Panel.

SK Foods had 59.1% of the voting rights in Cedenco when it made its offer. This meant that approximately 41% of the voting rights in the company were the subject of the offer.

To be able to rely on, and be bound by, rule 56(2), SK Foods would have had to have received acceptances from holders of approximately 21% of the outstanding shares in Cedenco, when it issued its acquisition notice. It had not done so.

Using rule 36 of the Code SK Foods obtained 2.71 million shares, or 17.6% of Cedenco's total voting rights, outside of the offer. The shares it had acquired under the offer amounted to some 2.13 million, or 13.8% of Cedenco's total voting rights.

*(Note: Rule 36 enables an offeror, during the course of an offer, where it has made a full offer for cash or including a cash alternative and the offer is unconditional, to obtain shares outside of the offer for cash. Typically these acquisitions will be on-market purchases for cash, but that was not the case with SK Foods which purchased shares by private treaty. If the consideration for any of these purchases is greater than the amount being offered in the offer then this is deemed to be a variation to the offer. While the offeror is able to make such purchases under rule 36, they do not count towards the requirement under rule 52(2) that acceptances be received for more than 50% of the shares the subject of the offer.)*

On the Panel's analysis SK Foods was some 1.02 million shares short of the acceptances needed to reach the 50% acceptance level when it issued its acquisition notice, and was still short of the required number when its offer closed on 15 September 2003.

SK Foods applied to the Panel for a retrospective exemption under section 45 of the Act. The exemption allowed SK Foods' flawed compulsory acquisition procedure to go ahead as planned but provided for the price to go to expert determination if sufficient shareholders objected. The exemption was structured so as to give effect to the requirements of the Code's compulsory acquisition provisions.

Significant features of the exemption granted by the Panel were:

- all shareholders whose acceptances had been received by SK Foods after it had issued its compulsory acquisition notice (because they may have been coerced into accepting the offer by SK Foods' acquisition notice), and all shareholders who had not accepted SK Foods' offer when it closed, could object to the compulsory acquisition price of \$2.30 per share;
- if 10% of these shareholders objected to the price then the amount of consideration to be paid would go to expert determination;
- if the expert determined that the consideration should be higher than \$2.30 then all shareholders who had accepted the offer and who had objected to the acquisition price, and all shareholders who had not accepted the offer when it had closed, would receive the higher amount; and
- if the expert determined that consideration should be less than \$2.30 then all those shareholders who had accepted the offer and objected to the price, and all those shareholders who had not accepted the offer when it closed, whether or not they had objected to the price, could have been required to repay any overpayment they had received, to SK Foods. (This is consistent with rule 62(2) of the Code.)

In the event less than 10% of the shareholders objected to the price and the expert determination process was not triggered.

This exemption highlights:

- if offerors wish to use the offer price as the compulsory acquisition price they need to monitor the extent to which

they acquire securities outside of the offer during the offer period;

· the effectiveness of the Panel's ability to grant retrospective exemptions. SK Foods was able to validly proceed with its compulsory acquisition while providing rights of objection to shareholders who had not accepted the offer or who may have been influenced by SK Foods' acquisition notice to accept the offer. If the Panel had not been able to grant a retrospective exemption SK Foods' flawed compulsory acquisition process could have become mired in legal challenge.

## Underwriters exemption review

As part of its function to keep the law relating to takeovers under review the Panel has been considering the continued appropriateness and effectiveness of the existing exemption for underwriters.

The existing underwriters class exemption was aimed at "professional" underwriters because the motivation of professional underwriters would be to obtain an underwriting fee in return for a commitment to take-up any shortfall in subscriptions to a new issue or a rights issue. It would not be to hold voting rights in a code company on a long term basis.

The Panel considers that there is a risk not adequately addressed by the terms of the existing exemption notice that corporate investors and their associates may subvert the policy behind the Code by using an underwriting commitment to increase their control in a code company.

Consequently, the Panel has decided that the class exemption for underwriters should be more restrictive than at present and should not apply if the underwriter has a collateral intention of using the underwriting agreement to increase the underwriter's (or its associates') voting control in a code company. Such an intention may be evidenced if the underwriter has previously expressed an intention to increase its control percentage in that code company.

The Panel has also been reconsidering the availability of the exemption to underwriters who already hold or control voting rights in the relevant code company.

The exemption currently applies to underwriters who hold or control voting rights provided that the underwriter otherwise meets the criteria of the exemption. However, where

underwriters and their associates already hold shares in the code company, there is a risk that the underwriter or its associates may have the purpose or intent of increasing their voting power in that company. Their shareholding already demonstrates that their interest in the company is not just as an underwriter, but as an investor.

Accordingly, the Panel considers that it is also desirable to amend the exemption to underwriters so that it is not available to an underwriter who is, or who when aggregated with its associates would be, a substantial security holder of voting rights in the code company.

### *Proposed Amendment*

The Panel proposes to amend the notice so that the exemption will apply only if:

- the purpose of the underwriter's entry into the underwriting or subunderwriting contract was to earn fees, commission or similar remuneration; and
- neither the underwriter nor any upstream party of the underwriter had a collateral purpose or intention, in respect of the underwriter's entry into the underwriting or subunderwriting contract, of enabling any person to increase that person's voting control; and
- immediately before the underwriter's entry into the underwriting or subunderwriting contract, the aggregate of the control percentages of the person and the person's associates did not exceed 5%.

A draft of the proposed amended exemption notice in respect of underwriters is published on the Panel's website. Last month the Panel sought submissions on the draft to be received by 19 March 2004. The Panel is now considering the submissions.

## [www.takeovers.govt.nz](http://www.takeovers.govt.nz)

The Panel's website is a comprehensive collection of the Panel's work and the legislation relating to takeovers.

Exemptions granted by the Panel are published in full, as are all determinations made by the Panel. The site also includes all issues of *Code Word*, speeches and articles, policies and guidance notes.

The site has a site map and search facility to assist visitors see what is available and quickly find the information they are looking for.

To keep up to date with the Takeovers Panel's work, register on the website [www.takeovers.govt.nz](http://www.takeovers.govt.nz), and you will receive email alerts to new material published on the site.

If you wish to receive Code Word in hard copy or by email please contact [catherine.chapman@takeovers.govt.nz](mailto:catherine.chapman@takeovers.govt.nz)

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