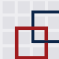
No. 12

JUNE 2004

THE NEWSLETTER OF THE TAKEOVERS PANEL

CODE WORD



TAKEOVERS PANEL

ISSN 1175-5040

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INDEPENDENT EXPERT APPOINTED

The Panel was required to appoint an independent expert for the purposes of rule 57 of the Code for the first time in March 2004.

The independent expert was appointed in respect of the compulsory acquisition of shares in Shotover Jet Limited by Ngai Tahu Holdings Corporation Limited.

An independent expert was required because Ngai Tahu received written objections to the consideration specified in its compulsory acquisition notice from outstanding shareholders who together held more than 10% of the outstanding voting rights.

Shareholders could object to the compulsory acquisition price because Ngai Tahu had become the dominant owner of Shotover as a result of a takeover offer in respect of which it received acceptances of less than 50% of the shares under offer.

The role of an independent expert is to determine the fair and reasonable value of an equity security. The amount determined by the expert is the amount the dominant owner must pay to outstanding security holders. It may be higher than, equal to, or lower than, the acquisition price specified by the dominant owner in the acquisition notice.

The Panel sought expressions of interest in the appointment. Six candidates applied.

The Panel needed to be satisfied that the candidate appointed was qualified and experienced to be an independent expert and was independent of both Ngai Tahu and Shotover Jet.

In considering the qualifications and experience that would be appropriate, the Panel noted that the role of independent expert under rule 57 is different from that undertaken by an independent adviser for the purposes of rule 21 where the independent adviser reports on the merits of the transaction. Under rule 57, the independent expert is only required to determine a cash sum equal to the fair and reasonable value of the securities to be compulsorily acquired. It does not need to report on the merits.

To select the most suitable candidate the Panel considered:

- the independence and qualifications of each applicant; and
- the level of fees each applicant would charge for the assignment.

The Panel appointed Horwath Porter Wigglesworth Limited on 16 March 2004 to determine the value of Shotover Jet, in compliance with the relevant provisions of the Code and in accordance with highest professional standards expected of an independent expert. It was left to Horwath Porter Wigglesworth to deal directly with Shotover Jet on the valuation process and related matters, such as confidentiality.

Some of the candidates told the Panel the specific methodology they would adopt to reach their determination if they were appointed. However, the methodology which a person might use to determine the value of the shares was not a factor in the Panel's decision-making. The Code requires that the independent expert calculate the value of a share by assessing the value of all of the equity securities in the class and then allocating that value pro rata among all of the securities of that class. However, it does not prescribe the specific methodology that the expert should adopt. The expert must decide the value of the share using a methodology which it considers appropriate.

Horwath Porter Wigglesworth sent its determination to Ngai Tahu on 13 April 2004. Ngai Tahu was required to send a copy of the determination to the Panel and the NZX immediately after it received the determination.

The value determined by Horwath Porter Wigglesworth was higher than the consideration specified in Ngai Tahu's compulsory acquisition notice. Accordingly, all outstanding shareholders were paid a "top-up" of the difference between the amount specified in the compulsory acquisition notice and the value of each Shotover Jet share determined by the expert.

The costs of the expert determination were required to be paid by Ngai Tahu, regardless of the outcome.

CLAUSE 20 – DISCLOSURE OF VALUATIONS

Three recent incidents have highlighted the meaning and importance of clause 20 of Schedule 2 of the Code (which contains the requirements of the target company statement). These incidents have shown:

- that valuations must be summarised and made available to shareholders if they are referred to specifically in the target company statement (which includes the independent adviser's report);
- that valuation reports do not just concern assets of the target company, but they may concern the target company itself, or other assets of relevance;
- in an exceptional case the Panel has been prepared to grant an exemption to allow parts of valuation reports containing commercially sensitive information to be deleted before being given to shareholders.

Trans Tasman Properties Limited

On 20 May 2004 the Panel considered a complaint from Latimer Holdings Limited relating to Trans Tasman Properties Limited's refusal to release to Latimer valuation reports it alleged were referred to in Trans Tasman Properties' target company statement.

The complaint arose after Trans Tasman Properties issued a target company statement and an independent adviser's report by Ferrier Hodgson & Co to its shareholders, in response to a takeover offer from SEA Holdings New Zealand Limited dated 20 April 2004.

Clause 20 refers to valuations of assets that are identified specifically in the target company statement. Trans Tasman Properties' target company statement had not focused on a particular valuation of a particular asset. The independent adviser was content to deal with property values on a global basis, consistent with the last published financial statements.

The Panel determined that the target company statement had complied with clause 20 of Schedule 2 of the Code. The Panel did not accept that the reference by the independent adviser to the financial statements contained in the annual report (which referred to valuations) amounted to a reference to "a valuation" in terms of clause 20. The clause requires a reference "to a valuation of any asset".

In addition to the obligation under clause 20, Schedule 2 of the Code also imposes obligations on the target company directors to consider matters such as asset valuations where they may be material, irrespective of the requirements of clause 20. If such valuations are considered material, the directors are obliged to make such information known to the company's shareholders.

Wrightson Limited

The recent target company statement issued by Wrightson Limited in response to the partial takeover offer from Rural Portfolio Investments Limited included references to a valuation report prepared by Cameron & Company.

Wrightson advised shareholders that it had sought from its advisers, Cameron & Company, a valuation report in addition to the rule 21 report that was prepared by Grant Samuel (the independent adviser appointed to prepare the rule 21 report).

The Panel sought comment from Wrightson as to whether the reference made to Cameron & Company's valuation report in the target company statement would require the company to provide the report to shareholders on request, as part of its obligation under clause 20 of Schedule 2 of the Code.

Wrightson said that it did not need to comply with clause 20 because Cameron & Company's valuation was a valuation of Wrightson as a whole rather than of a specific asset or assets held by Wrightson.

The Panel considered that clause 20 did not have the narrow interpretation suggested by Wrightson. The requirements in clause 20 apply if the target company statement refers to a valuation of any asset and is not restricted to a specific asset of the target company.

Subsequently, Wrightson took steps to provide the information required by clause 20 to shareholders, including a statement that a copy of the valuation would be available, in full, to any offeree on request.

Kingsgate International Corporation Limited – Clause 20 Exemption

The Panel granted an exemption to Kingsgate International Corporation Limited from clause 20(b) of Schedule 2 of the Code. The exemption allowed Kingsgate to provide upon request, copies of the relevant valuation reports, in a form which excluded information which the Panel had agreed was commercially sensitive.

Grant Samuel, in its independent adviser's report, had referred to valuations of various Australian properties owned by Kingsgate, which were carried out by CB Richard Ellis. These valuation reports had not been prepared with a view to public disclosure, and contained very detailed information about the properties involved.

In considering whether to approve Kingsgate's request for the exclusion of certain information from the valuations, the Panel used the following criteria:

- Is the information sought to be withheld material to a decision by Kingsgate shareholders to accept or reject the current takeover offer?
- Is the information sought to be withheld likely to be "value destroying" information for shareholders of Kingsgate?

- Is the information sought to be withheld commercially sensitive?

The Panel regards the Kingsgate exemption as exceptional and does not expect to have to consider similar reports in future.

PANEL INTERVENES IN TAKEOVER

Restaurant Brands Limited received a takeover notice on Friday 14 May 2004 from King Win Laurel International Limited, a company based in Auckland.

As required by rule 42 of the Code, Restaurant Brands notified the NZX that it had received the takeover notice from King Win. The same day the Panel received a copy of the takeover notice sent to Restaurant Brands Limited by King Win.

It was immediately apparent to the Panel executive and to the legal advisers to Restaurant Brands, that the takeover notice did not comply with the Code in a number of respects. Restaurant Brands included comments to this effect in its statement to the Exchange.

The Panel's objective was to have the notice withdrawn from the market as quickly as possible, and preferably without expensive regulatory action.

The Panel wrote to King Win on the day the notice was received asking it to withdraw its notice. The following Monday (17 May) the Panel executive spoke with a representative of King Win and explained the reasons why the takeover notice did not comply with the Code. King Win was again asked to withdraw its notice. King Win was given the clear understanding that the Panel would act to restrain the offer if it were necessary to do so. On Tuesday 18 May King Win advised the Panel and Restaurant Brands that it had withdrawn its takeover notice.

The notification of the takeover notice, despite the immediate comments from Restaurant Brands, appeared to result in a temporary lift in the Restaurant Brands' share price.

Some media commentators have said that the King Win takeover notice should not have been notified to the market because it was so obviously non-complying with the Code. The Panel does not accept this. While the short-term increase in Restaurant Brands' share price may have been unfortunate, the Panel considers it is not for target companies to withhold from shareholders the information that a takeover notice has been received that purports to comply with the rules of the Code.

The Panel considers that Restaurant Brands was correct to add its own warning about the form of the offer in the statement it released to NZX.

The Panel believes that King Win was genuine in giving its takeover notice, but lacked understanding of the full mechanism required for a Code offer.

This incident demonstrates the importance of participants in the takeover market taking proper legal advice before embarking on a takeover transaction. It also illustrates that the Panel is prepared to achieve its regulatory objectives without undertaking heavy-handed intervention where it can reasonably do so.

EXEMPTIONS FROM RULE 22

The Panel has recently received queries about circumstances in which it might grant an exemption from the requirement for an independent adviser's report under rule 22 of the Code.

A rule 22 report must be contained in or accompany an offer:

- if the target company has more than one class of voting securities; or
- if non-voting securities are included in the offer.

The independent adviser must certify in the report that, in its opinion, the consideration offered is fair and reasonable as between different classes. Once the independent adviser has given this certification the offer is deemed to comply with rule 8(3), 8(4) or 9(4), whichever is applicable.

The purpose of rule 22 is to:

- advise shareholders that the price offered for the securities held by them is fair and reasonable compared with the amount offered to holders of securities of a different class; and
- avoid a legal challenge to a takeover on the grounds that the consideration offered for different classes of security is not fair and reasonable as between the classes.

Consistent with the underlying purpose of rule 22, the Panel would only be likely to grant an exemption from the requirement for a rule 22 report if it is satisfied that in the particular circumstances of the relevant code company there is, in effect, only one class of voting securities under offer.

These circumstances were demonstrated by St Laurence Property & Finance Limited in its offers for parcels of shares and mortgage bonds in Capital Office Fund Limited and Mt Wellington Industrial Fund Limited.

The offers related to two classes of securities, one voting and one non-voting, which were "stapled" together. Without an exemption St Laurence would have had to obtain a rule 22 report on the fairness of the considerations offered as between these two classes. However, the shares and bonds had been issued by each of the code companies in parcels which could not be separated. The shares and bonds could not be traded separately, and the consideration offered by St Laurence related to each parcel and did not distinguish between the components of the parcel. To have done so would have been artificial.

The Panel considered that because the parcels of shares and bonds were inseparable there was effectively only one class of security holder i.e. holders of parcels of shares and mortgage bonds. No shareholder would, in effect, hold a different class of securities from other shareholders. Also, because security holders could not sell only their shares or only their bonds, the shares and bonds did not have a value independent of the parcel of which they were part.

In these circumstances the Panel considered that a rule 22 report on fairness between the shares and the bonds would have no meaning, and that an exemption from rule 22 was appropriate.

However, the Panel is unlikely to consider that there is, in effect, only one class of voting securities merely because two different classes of securities that are quite similar in nature, with only minor differences, are regarded by the market (based on price) as being virtually the same.

If the Panel were to grant an exemption from rule 22 in these circumstances it would, in effect, be certifying that the differences between the classes of security had no effect on the value of the securities. The Panel is not in a position to do this.

Even in circumstances where the securities are substantially similar a rule 22 report gives useful information for shareholders. For example, in the recent offer by Rubicon Forests Limited for Tenon Limited, Tenon had two types of share on issue, ordinary shares and preference shares. Both classes of share carried identical voting rights but one class had a temporary preferential status upon liquidation. Although the two classes of shares had recently traded at the same price, it was not certain that this would always be the case. The rule 22 report told shareholders that, in the opinion of the independent adviser, the (identical) consideration offered by Rubicon for each type of share was fair and reasonable as between the two classes of shares.

Another circumstance would be where identical securities were on issue, but some were held by employee shareholders subject to loan obligations back to the company, or on a partly paid-up basis. A rule 22 report is likely to be required in such circumstances.

Offerors considering applying for an exemption from rule 22 should first consider whether the Panel would be likely to be satisfied that, in respect of the relevant code company:

- all shareholders hold the same rights; and
- there was no possibility that holders of different securities could get a different value for their securities, or be entitled to different treatment or be subject to different constraints on their ability to sell their securities.

In these circumstances the Panel would be likely to consider that there is, in effect, only one class of voting securities.

Recent Issues

PANEL CONSIDERS ALLEGATIONS OF DEFENSIVE TACTICS

The Panel recently considered an allegation of defensive tactics made by Rubicon Limited in relation to the actions, or inactions, of the directors of Tenon Limited in response to Rubicon's (successful) partial offer.

The Panel's determination of the complaint found that Tenon's directors had not contravened the Code's prohibition on defensive tactics. The matter highlighted several aspects of the interpretation of rule 38 of the Code, including:

- that "an action" by the directors of a company can include a decision to not act;
- that an action "in relation to the affairs of a Code company" contemplates interference with the ongoing undertaking of a company's business. This might include selling assets, issuing further shares, declaring an extraordinary dividend or such other initiatives that alter the nature and extent of the business the offeror has taken into account in making the offer. However the scope of the phrase does not extend to a refusal to respond to a requirement that an offeror purports to make under the terms of its offer.

Two of the conditions of Rubicon's partial offer purported to impose obligations on Tenon's directors to provide information about aspects of its affairs to Rubicon, or to an expert appointed by Rubicon.

These conditions were "change of control" conditions to address the risk that in the event of a change of control of Tenon:

- no shares, notes options or other securities held or controlled by Tenon would be forfeited, transferred or subject to any right of pre-emption that could have a material adverse impact on the Tenon group's financial position;
- Tenon's interests in any concession, lease, grant, permit, license, franchise, timber cutting, farming, mining or growing right etc would not be materially and prejudicially affected.

The conditions required Tenon's directors to confirm to Rubicon no later than 7 days after the date of the offer that no such adverse outcomes could occur, or, if the directors of Tenon failed to so confirm, that an expert appointed by, but not an associate of, Rubicon would provide the confirmation sought.

Tenon's directors declined to provide the confirmations sought. In a public release, Tenon told shareholders that it did not intend to provide information to an expert to enable the expert to confirm that the defined adverse consequences would not arise from a change of control of Tenon.

Rubicon alleged that the decision by Tenon's directors not to assist Rubicon by satisfying the terms of two important conditions of its offer amounted to an action designed to frustrate its offer. Rubicon claimed that this contravened rule 38 of the Code.

The Panel's view is that the Code's restriction of defensive tactics does not oblige directors to provide information required by an offeror. The board of the target company should not be manoeuvred by conditions included by an offeror in its offer into a position where it can be suggested it is in breach of the rule 38 prohibition on defensive tactics merely by refusing to provide information or give access to information.

The application of rule 38 should not be influenced by how relatively important any requested information might be to the offeror, or by how relatively innocuous it would be for the target company to comply.

The Panel drew attention to the obligations of target company directors, under general law and various provisions of Schedule 2 of the Code, to provide information to shareholders in the target company statement.

The Panel rejected a proposition by Tenon's directors that they could somehow "barter" information in the pursuit of the best possible offer or offers for shares in the company. This was particularly so insofar as all relevant information is required to be disclosed under clauses 18(5) and 24 of the Second Schedule of the Code. The Panel noted that it would be improper, and in breach of their duties under the Code, for directors to withhold information that is material to an investor considering the offer because they saw some advantage in negotiating with the offeror for better terms in the offer in return for a greater level of disclosure.

The determination is available on the Panel's website.

DIRECTORS CERTIFICATES – TRANS TASMAN PROPERTIES

The Panel recently granted an exemption which recognised the difficulties that can arise when a person has executive positions in both a bidder and a target company.

On 20 April 2004, SEA Holdings New Zealand Limited made a full offer for all the voting rights in Trans Tasman Properties Limited. In the course of preparing its target company statement, Trans Tasman advised the Panel that it believed one of the requirements under Schedule 2 of the Code was inappropriate.

Trans Tasman advised that Mr Donald Fletcher was both the chief executive officer and chairman of its board of directors. Trans Tasman also informed the Panel that Mr Fletcher was also a director and chief executive officer of the bidder, SEANZ.

Trans Tasman sought an exemption from sub-clause 26(1) of Schedule 2 to the extent that the sub-clause requires a certificate to be signed by the chief executive officer of Trans Tasman, Mr Fletcher.

The Panel granted an exemption to Trans Tasman. The exemption was subject to two conditions. The first was that the target company statement must include a modified certificate signed by Mr Fletcher alone. The modified certificate required Mr Fletcher, in his role as the chief executive officer of Trans Tasman, to certify that he had provided and disclosed all information required under the Code to the directors of the target company so they could complete the target company statement.

The certificate also required Mr Fletcher to certify that the information he had provided was, in all material respects, true and correct and not misleading, whether by omission of any information or otherwise.

The second condition was that the target company statement must also include notice of the exemption, and the reasons for the granting of the exemption, in a form approved by the Panel.

The Panel granted the exemption because of the conflicts of interest inherent in Mr Fletcher's roles as the chief executive officer of the bidder and also of the target company. The exemption still required Mr Fletcher to make available to the Trans Tasman board all relevant information possessed by him.

Professional underwriters class exemption

Underwriting is an established feature of capital market activity in New Zealand which the Panel believes it should facilitate by appropriate exemption.

The difficulty is that when a professional underwriter agrees to underwrite a share or rights issue the outcome in Code terms is not known. The underwriter may or may not obtain more than 20% of the voting control of the code company. The intention of the professional underwriters class exemption is to allow the underwriter to support the issue, but if it acquires over 20% of the voting rights in the code company it must sell down its holding within six months and cannot vote its additional shares in the meantime.

The Panel originally granted a class exemption for professional underwriters in clause 19 of the Takeovers Code (Class Exemptions) Notice (No.2) 2001. That has now been replaced with a new exemption.

The Panel replaced the previous class exemption for underwriters because it considered it did not adequately address the risk that corporate investors and their associates may use an underwriting commitment for the purpose of increasing their control in a code company.

The Panel sought public comment on the proposed form of the exemption but received very few submissions. However, most of the submissions received supported the replacement exemption.

The Takeovers Code (Professional Underwriters) Exemption Notice 2004 was notified in the New Zealand Gazette on 27 May 2004 and applied from that date.

The Professional Underwriters Exemption Notice exempts professional underwriters from the fundamental rule in respect of any increase in their percentage of voting rights resulting from fulfilling their obligations under a bona fide underwriting arrangement. Like the previous class exemption it is subject to the conditions that:

- any increase in voting control above 20% is eliminated within 6 months; and
- the additional voting rights are not exercised before that elimination.

However, under the conditions of the new notice 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 intent, in entering into the underwriting or subunderwriting contract, of enabling any person to increase their 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%.

Where a code company is making a rights issue to existing shareholders and the underwriter would not satisfy the conditions of the Professional Underwriters Exemption Notice, the underwriter will not be able to increase its control of voting rights in the code company above the 20% level unless it is able to obtain a specific exemption from the Panel.

The Panel meets the markets

Although the Takeovers Panel is a Crown Entity with its offices in Wellington, it likes to keep in touch with the market and to hear market participants' views on how it is doing its job.

To this end the Chairman, Deputy Chairman, some Panel members, and members of the executive met recently with market participants at two meetings in Wellington and one in Christchurch. These followed similar lines to two successful meetings in Auckland last year.

Some 17 financial advisers and interested persons from Auckland and Wellington came to the first Wellington meeting. The Panel's policies for approving independent adviser appointments, its approach to appointing independent experts, and the Panel executive's role in reviewing draft independent adviser reports were discussed along with other current issues.

The second Wellington meeting was attended by 18 lawyers from Auckland and Wellington who are active in the takeover market. Discussion was wide-ranging, covering the Panel's policies relating to the approval of independent advisers and appointment of experts, the granting of exemptions from the Code, and the approach to enforcement issues. Nine market participants attended the Christchurch meeting where discussion covered a similar range of issues.

These meetings are a significant commitment by Panel members and the executive, but the Panel believes it is important to hear directly from key market participants in an open forum where everyone has the opportunity to make their views known to the Panel.

Technical amendments to the Code

The Panel recommended a number of technical changes to the Code to the Minister of Commerce late last year. These recommendations followed the Panel's consideration of detailed submissions on a discussion paper outlining changes to the Code proposed by the Panel.

The changes range from a few proposals which aim to clarify the wording of the Code, to several proposals designed to make the Code work better in particular circumstances. None of the proposals would make fundamental changes to the Code's structure. All the proposals result from the market's experience with the operations of the Code in the first three years it has been in force.

The Panel's proposals are currently being considered by officials of the Ministry of Economic Development. The Panel is assisting this process as required. The next steps will be formal consideration by the Government and then final drafting of changes by Parliamentary Counsel Office.

The Panel hopes that the changes could be implemented in September/October 2004.

If you wish to receive Code Word in hard copy or by email please contact catherine.chapman@takeovers.govt.nz

How to contact us

Takeovers Panel
Level 8, Unisys House
56 The Terrace
PO Box 1171
Wellington

Phone: 64 4 471 4618
Fax: 64 4 471 4619
Email: takeovers.panel@takeovers.govt.nz
Website: www.takeovers.govt.nz

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