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TAKEOVER DOCUMENTS

THIS EDITION OF CODE WORD IS PRIMARILY DEVOTED TO THE CONTENT OF TAKEOVER DOCUMENTS AND THEIR COMPLIANCE WITH THE TAKEOVERS CODE.

Takeover documents Compliance with the Code

The Panel's executive routinely checks takeover notices, takeover offer documents and target company statements for compliance with the Code.

From some recent examples it appears that companies and their legal advisers treat compliance with the Code as an option rather than a legal obligation. This is not the case and the Panel will take appropriate enforcement action if documents do not comply.

Some areas where compliance with the Code has raised difficult issues, mostly for target companies, are discussed below. This article does not discuss the ongoing issues relating to Oyster Bay.

DISCLOSURE OF ASSUMPTIONS UNDERLYING FORECASTS

Schedule 2 of the Code sets out the requirements of the target company statement, i.e. the statement that a target company must issue in response to a takeover offer. The target company must send to the offeror and to every offeree ... *a statement containing, or accompanied by, the information specified in Schedule 2 ...* (Rule 46)

The target company statement must include ... *the identity of the independent adviser who has provided a report under rule 21 and a copy of the adviser's full report or a summary of the full report prepared by the adviser.* (Clause 19 of Schedule 2)

Clause 21 of Schedule 2 states that *If any information provided in the target company statement refers to prospective financial information, the principal assumptions on which the prospective financial information is based.*

The Panel interprets Schedule 2 as meaning that the independent adviser's report on the merits of an offer (as required by Rule 21) is part of the *target company statement* for the purposes of clause 21 of Schedule 2.

Independent adviser reports often give prospective financial information, comprising financial forecasts of the target company for one or two years ahead. Invariably, given the short time which advisers have to prepare their *merits* reports, these forecasts will be based on information provided by the target company management.

If an incumbent board or management is resisting a hostile takeover there is an incentive to exaggerate the value of the target company to make the bid appear low. This may appear to be in the interests of shareholders if it pushes up the offer price, but it may not be in the company's interests if it frustrates a much-needed change of control.

Where an incumbent management supports a takeover offer, possibly one made by an existing majority holder for the shares it does not already hold, there is less incentive for management to inflate the value of the company. In these circumstances information about the target company's future prospects that is given to the adviser may be relatively conservative.

Partly because of these varying possibilities the Code requires the target company statement (including the independent adviser's report) to state the principal assumptions on which any prospective financial information is based. It is expected that the assumptions will directly accompany the prospective financial information in the document.

The Panel executive has seen instances where the principal assumptions underlying prospective financial information have either not been stated or have been stated in such a bland way that they disclose little information that is useful or relevant.

When considering the adequacy of disclosed assumptions the Panel notes this advice from the New Zealand Institute of Chartered Accountants:

Prospective financial information will be based on many assumptions about future conditions and events which may or may not occur. The quality of the information will be dependent largely on the appropriateness of these assumptions. Therefore, users are to be provided with these assumptions so as to make their own informed judgement on the quality and reliability of the assumptions. For users to make their own informed judgement, it is necessary to provide information which assists them in assessing the sensitivity of prospective financial information to changes in assumptions which are subject to high degrees of uncertainty.

(FRS-29 Prospective Financial Information issued in 1996 paragraph 5.6)

Where target company statements and independent adviser reports do not include an adequate description of the principal assumptions underlying any prospective financial information that they contain, the Panel has generally required the target company to issue a correcting statement. This has to be distributed to all target company shareholders to mitigate the effect of what is, in essence, a breach of the Code.

If the correcting statement is distributed to target company shareholders without delay the Panel is unlikely to take any further enforcement action.

Those who prepare target company statements and independent adviser reports should ensure that the principal assumptions underlying any prospective financial information are adequately described.

INFORMATION ABOUT ASSET VALUATIONS

The Code states that the target company statement must include *If any information in the target company statement refers to a valuation of any asset, (a) the date of the valuation, the identity of the valuer, and a summary of the valuation, that discloses the basis of computation and the key assumptions on which the valuation is based; and (b) an address or addresses where copies of the valuation are available for inspection and a statement that a copy of the valuation will be sent to any offeree on request.* (Clause 20 of Schedule 2)

This requirement applies whether the independent adviser's report or another part of the target company statement refers to the valuation of the asset. The disclosure required by clause 20 can be in the body of the independent adviser's report and/or in the directors' part of the target company statement. Disclosure in either place will comply.

Where a target company is a property development company, with a significant number of investment properties which are included in the company's financial statements at market value, this reference in the financial statements will not generally constitute a reference to the *valuation of an asset* for the purposes of clause 20. Specific reference to valuations of one or more individual assets would be needed for the disclosure requirements to be triggered.

If a target company commissions its own expert opinion on the value of its shares and refers to this value in the target company statement (in addition to the independent adviser's report) then the Panel is likely to consider that this is the *valuation of an asset* (being the value of the target company itself). This should be summarised in the target company statement to the extent required by clause 20 and be available to any shareholder who requests it.

INFORMATION ABOUT MATERIAL CHANGES IN THE FINANCIAL OR TRADING POSITION OF THE TARGET COMPANY

The target company statement must include *All material changes in the financial or trading position, or prospects, of the target company since the annual report referred to in subclause (1) [being the most recent annual report] or a statement that there are no known material changes.* (Clause 18(4) of Schedule 2)

Sometimes quite a long time may have elapsed between the company's last annual report and the target company statement. Interim financial statements may have been published in that time. An independent adviser's report will usually include prospective financial information. However, clause 18(4) requires all material changes in the financial position or prospects of the target company since the last annual report to be identified.

Subsequent interim financial statements or the independent adviser's report are not enough for compliance, unless the independent adviser's report specifically identifies the material changes that have occurred since the last annual report.

APPROVAL OF TARGET COMPANY STATEMENT

The target company statement must include *(1) A statement that the contents of the target company statement have been approved by the board of directors of the target company and (2) If any of the directors of the target company do not approve of the statement, their names and their reasons for not approving.* (Clause 25 of Schedule 2)

It is common for a target company board to establish a committee of independent directors to handle all aspects of a takeover. This is particularly likely where an existing major shareholder is bidding to increase its stake, or an existing major shareholder has entered into a pre-bid lock-up arrangement with a new external party. This committee normally has fully delegated authority from the board of directors.

The Panel considers it is acceptable for a committee of independent directors to *approve* the contents of the target company statement for the board of directors. However, all other directors must explicitly *not approve* the statement and explain why in the target company statement.

A problem can arise if the target company statement includes information relating to the interests of directors and officers of the target company in material contracts with the bidder (as required by clause 13 of Schedule 2). In particular, officers or directors of the target company who are also officers or directors of the bidder, will probably have contractual arrangements with the bidder. However, the independent directors of the target company, who have to approve the statement, may not be privy to information about the interests of directors and officers unless those persons tell them. Non-independent directors are obliged to disclose information about any contractual arrangements with the bidder to the independent directors who are to approve the statement.

For their part, independent directors should ensure that non-independent directors verify information in the target company statement about the interests of directors and officers in any material contracts they have with the offeror or its related parties before they (the independent directors) approve the statement.

SIGNING OF CERTIFICATES FOR OFFER DOCUMENTS AND TARGET COMPANY STATEMENTS

The Code prescribes the certificates that must be signed for the offeror in the offer document and the target company in the target company statement. The certificates require a combination of executive and board level responsibility to be taken for the contents of the offer document and target company statement. (Clause 19 of Schedule 1 and clause 26 of Schedule 2)

The executives who must sign the *certificate* in the offer document and the target company statement respectively are specified in clause 19(2)(b)(i) of Schedule 1 and clause 26(2)(a) of Schedule 2. These clauses state that the certificate must be signed by *The chief executive officer and the chief financial officer of the offeror [the target company] or their respective agents authorised in writing, or if there is no chief executive officer or chief financial officer, the person or persons fulfilling those roles respectively, or their respective agents authorised in writing.*

In several instances takeover notices reviewed by the Panel executive indicated that the subsequent takeover offer document would not be signed by a person in one or other of the executive capacities. In these instances the Panel executive usually talks to the offeror's legal advisers to ascertain who is filling the executive roles. In one or two instances the offeror's advisers have overlooked that there are incumbent executives filling these roles although they don't have the job titles. In other instances the offeror has been a small investment holding vehicle with only one or two directors and no executive staff. In these cases the

directors must be filling the executive roles and should sign the certificates. The issue is the role and not the titles. Those who fulfil the roles have to sign the certificates.

Where target company statements have been issued without being signed by the responsible executives the Panel has acted swiftly to have the matter remedied. In one case the target company had overlooked the need to have the chief executive sign the document while the chief financial officer (a secondee from an accounting firm) had not signed because he thought that the contractual arrangements between the accounting firm and the target company prevented him from doing so. It was only after the Panel had called a section 32 meeting to deal with the non-compliance that the chief financial officer signed (by way of an addendum) the target company statement.

The requirement for the chief executive officer and the chief financial officer (or the persons fulfilling these roles) to sign the target company statement is a legal obligation that must be complied with. The only exception would be if the Panel granted an exemption. See Practice Note - *Exemptions from Clause 26 of Schedule 2* on page 4 of this issue of *Code Word*.

THE REQUIREMENTS FOR "PARTICULARS" IN OFFER DOCUMENTS AND TARGET COMPANY STATEMENTS

The offer document or target company statement must include the *particulars* of agreements or arrangements entered into, or of interests in contracts, or of restrictions in company constitutions that are relevant to the takeover transaction. (Clauses 10, 11, 12, 15 and 16 of Schedule 1 and 10, 11, 12, 13, and 16 of Schedule 2) There is a tendency in takeover documents for responses to the requirements of these clauses to be general rather than particular.

In the Panel's view *particulars* means names and amounts.

Clause 12 of Schedule 2 covers the circumstances where a target company has entered into certain arrangements with its directors and/or senior officers. These arrangements relate to payments or other benefits for compensation for loss of office, or remaining in or retiring from office. These payments may be quite modest and reasonable. Or they may be *poison pills*, i.e. very large payments that entrench existing management by having a significant adverse effect on the value of the target company if a takeover succeeds.

The Panel expects the names of the people concerned and the amounts of the prospective payments to be disclosed. The amounts may be disclosed in terms of multiples of salary (e.g. 3 months' salary, one year's salary) in some instances.

If the amounts are modest and reasonable, disclosure should not cause any embarrassment or discomfort. If the amounts are large, disclosure of the amounts and the names of the recipients is very important. If the names and amounts are not disclosed, the offerees and the market will not know if there is reason for concern.

The offeror must disclose details of any agreement or arrangement, made or proposed, under which the target company or its related companies will give direct or indirect financial assistance in connection with the offer. (Clause 12 of Schedule 1)

In some instances where takeovers are virtually bound to succeed (e.g. a majority owner increasing its stake with pre-bid agreements in place) the response to this clause has been a vague statement about existing financing arrangements possibly being extended to cover the assets of the target company if the takeover succeeds. This does not comply with the requirement to disclose particulars of arrangements under which the target company will give financial assistance in connection with the offer. The Panel will insist on supplementary disclosure that identifies the parties with whom the financing arrangements have been made and the nature of those arrangements.

WE'RE HERE TO HELP

The Panel appreciates that the form of takeover documents is evolving as the market gains experience with the Code. The Panel executive is happy to discuss takeover disclosure issues with the legal advisers to offerors and target companies before documents are finalised. This advice is without prejudice to the Panel's position if a document is later challenged, but many potential problems can be averted ahead of time by a call to the Panel executive.

Practice Note Exemptions from clause 26 of schedule 2 of the Code

Rule 46 of the Code requires a target company, on receipt of a takeover offer, to prepare a target company statement for distribution to its shareholders. That statement must be certified by two directors and two senior executives of the company in accordance with clause 26 of Schedule 2 of the Code.

The Panel considers that clause 26 certification is an important requirement of the Code. (See also *Takeover documents must comply with the Code* on page 1.).

The Panel has recently declined several applications for exemption from the requirements of clause 26. This practice note aims to help market participants understand the Panel's approach when considering requests for exemption from clause 26.

CLAUSE 26 CERTIFICATES

Clause 26 requires the chief executive officer, the chief financial officer, and two directors of the target company to certify that to the best of their knowledge and belief, after making proper enquiry, the information contained in or accompanying the target company statement is *true and correct and not misleading, whether by omission of any information or otherwise, and includes all the information required to be disclosed by the target company under the Takeovers Code.*

The intention of clause 26 is to ensure that the target company's two most relevant senior executives share responsibility for the factual accuracy of the target company statement. The chief executive officer and chief financial officer must be involved in this process because of their detailed knowledge of the affairs of the company, knowledge which directors may not have. The senior executives are not required to make recommendations to accept or reject the offer; that is a matter for the independent directors of the target company. Nor are they required to certify opinions, such as those expressed in the independent adviser's report which forms part of the target company statement (see clause 19). However, the certificate does extend to the contents of the independent adviser's report, including its analysis.

EXEMPTIONS DECLINED

Two representative examples of applications for exemption from clause 26 which the Panel has declined are discussed below.

One unsuccessful application was for an exemption in respect of the chief executive officer and the chief financial officer of a target company who also held the same positions with the offeror. The offeror had over 80% of shares in the target company when the takeover offer was made. The applicant submitted that it would be inappropriate, and contrary to usual practices of good corporate governance, for the senior executives to certify the target company statement. The Panel would not grant the exemption to the two senior executives because, as a consequence, no senior executive of the target company would be taking responsibility for the information contained in or accompanying the target company statement. The Panel invited the target company to provide specific reasons why one or other of the senior executives should be exempted. No specific reasons, other than a perceived conflict of interest, were given and the Panel therefore declined the application.

A second unsuccessful application sought a retrospective exemption for the chief financial officer not to have to sign the clause 26 certificate. The Panel was told that the chief financial officer was on secondment to the target company and was prevented by the terms of his engagement from making any public statement relating to the target company. It was proposed that the next most senior financial officer of the target company could certify instead. In response, the Panel said that the chief financial officer could not avoid the clause 26 requirement because the secondment contract was subject to the overriding effect of rule 5 of the Code (which prevents parties from contracting out of the Code).

In at least two other takeovers the target company has been managed by the offeror and employed no executive staff of its own. In both these cases senior executives of the offeror signed the target company statement in their capacity as persons fulfilling the roles of senior executives of the target company. Although they had conflicts of interest, these people were responsible for the executive functions of the target company, including briefing the independent adviser about the target

company's prospects, so it would not be appropriate to exempt them from the obligation to sign the certificate.

EXEMPTION GRANTED

The Panel has only granted one exemption from clause 26. The Takeovers Code (Trans Tasman Properties Limited) Exemption Notice 2004 was briefly noted in *Code Word 12* (June 2004). SEA Holdings New Zealand Limited (SEA Holdings), already the controlling shareholder, made a controversial takeover offer for the shares it did not own in Trans Tasman Properties Limited (Trans Tasman). The independent directors of Trans Tasman were expected to reject the takeover offer. The independent adviser's report prepared under rule 21 of the Code had concluded that it was neither fair nor reasonable. There were several shareholders who appeared quite hostile to SEA Holdings increasing its interest in Trans Tasman.

Trans Tasman applied for an exemption from the requirement that the chief executive officer certify the target company statement. The same person was chief executive officer of both Trans Tasman and SEA Holdings. He was also chairman of Trans Tasman and a director of SEA Holdings.

The Panel granted the exemption for the stated reason that *it was necessary to take into account the conflict of interest inherent in [the same person's] roles as the chief executive officer of the offeror and also of the target company.*

Some market participants appear to have interpreted this explanation to mean that an exemption from clause 26 will be appropriate in every case where a chief executive officer or chief financial officer is conflicted.

The Panel did not intend the explanation to be interpreted in this way. The circumstances of the SEA Holdings takeover offer were unusual and the Panel granted the exemption in recognition of the particular difficulties faced by the chief executive officer, which went beyond the conflict of roles.

Clause 25 did not assist the chief executive officer. Clause 25 requires the target company statement to include a statement that its contents have been approved by the "board of directors of the target company" and, if "any of the directors of the target company" do not approve of the statement, their names and their reasons for not approving it. The independent directors of Trans Tasman had approved the target company statement. The chief executive officer, because of his association with SEA Holdings, was not a member of the committee. As a result, he was not asked to approve the target company statement in his capacity as a director of Trans Tasman.

The exemption was subject to the condition that the chief executive officer sign a modified form of certificate, stating that he had provided all relevant information that Trans Tasman was obliged to disclose under the Code and necessary to enable Trans Tasman directors to sign the clause 26 certificate. The modified certificate also required the chief executive officer to

state that the information he had provided was *true and correct and not misleading.*

SUMMARY

The clause 26 certificate is an important component of the target company statement. The Panel will only grant exemptions from this requirement when there are particularly compelling reasons to do so. The Panel expects such circumstances to be rare.

This practice note is provided for guidance only. While it signals the attitude of the Panel at this time the Panel is not bound by this or any other practice note.

Oyster Bay

PANEL DECISION ON OMISSION OF MATERIAL INFORMATION IN TARGET COMPANY STATEMENT UPHeld BY HIGH COURT

The protracted takeover process for control of Oyster Bay Marlborough Vineyards Limited began in July 2005 when Delegat's Wine Estate Limited (Delegat's) and Peter Yealands Investments Limited (PYIL) each made partial takeover offers for Oyster Bay.

The Delegat's offer was due to close on 19 September 2005. It had been successful in that Delegat's had sufficient acceptances to take its holding of voting rights in Oyster Bay to 50.1% after the offer had closed and after scaling.

On 19 July 2005 Oyster Bay had issued a target company statement in response to the Delegat's offer. That statement included an independent adviser's report by Ferrier Hodgson & Co.

The target company statement is a fundamental requirement under the Code in response to a takeover offer. It is issued by the directors of the target company to assist shareholders in deciding whether to accept or reject the offer. The statement contains important factual information about the target company, an independent adviser's report, a recommendation by the directors in relation to the offer and the basis for that recommendation.

The Panel received complaints from PYIL which had made a competing but unsuccessful partial offer to obtain 51.1% of the voting rights of Oyster Bay, and from David Rankin, an Oyster Bay shareholder.

PYIL's first complaint related to the non-disclosure of certain detailed information about Oyster Bay's grape harvest and the sale of its grapes to Delegat's under existing long-term arrangements. After considering information summoned from Oyster Bay and comments from the independent directors, the Panel decided to take no action.

PYIL's second complaint, and that by Mr Rankin, concerned the market value of Oyster Bay's vineyard properties. The target company statement referred to a net tangible asset basis of valuation of Oyster Bay using a valuation for the vineyard

properties prepared by Logan Stone Limited. Logan Stone used a discounted cash flow or income approach in its valuation of the vineyard properties. The reason given for adopting the income approach was that there was said to be no relevance in the market value of the properties because they were subject to long-term agreements with Delegat's.

Both Mr Rankin and PYIL alleged that the target company statement should have included information about the market value of Oyster Bay's vineyard assets, unencumbered by the long term agreements with Delegat's.

The independent directors of Oyster Bay submitted that this information would be inappropriate and misleading for shareholders because any sale of the properties would be subject to contracts with Delegat's.

The Panel considered that information about the market value of Oyster Bay's properties, suitably qualified to reflect Delegat's contractual entitlements, may be information that could reasonably be expected to be material to decisions by Oyster Bay's shareholders to accept or reject Delegat's offer. By issuing the target company statement without this information the Panel considered Oyster Bay may not have complied or may not be complying with clauses 18(5) and 24 of Schedule 2 of the Code.

The Panel decided on 14 September 2005 to hold a meeting under section 32 to determine the issue. Interim restraining orders were made directing Delegat's not to declare its offer unconditional and restraining Oyster Bay from registering the transfer or transmission of any securities arising from the acceptances of Delegat's offer. The restraining orders did not prevent Oyster Bay shareholders from accepting Delegat's offer prior to its close on 19 September 2005. The purpose of the orders was solely to preserve the status quo until the matter was resolved.

The Panel met on 20 September 2005 to consider the matter in light of the relevant provisions of the Code which are:

- Clause 18(5) of Schedule 2 which requires the target company statement to include *any other information about the assets, liabilities, profitability, and financial affairs of the target company that could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the offer*; and
- Clause 24 of Schedule 2 which requires the target company statement to include *any other information not required to be disclosed by this schedule that could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the offer*.

Clauses 18(5) and 24 require disclosure in the target company statement of all information about the assets and financial affairs of the target company, or any other information, that *could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the offer*. As to the appropriate interpretative approach to clauses 18(5) and 24, the

Panel considered that the directors of target companies should take into account the following points:

- The question whether particular information could reasonably be expected to be material to the making of a decision by the offerees to accept or reject the offer is essentially a question to be resolved having regard to the particular circumstances.
- The issue of reasonableness requires an objective test based upon an hypothetical reasonable director in the position of having responsibility for preparing the target company statement, and without reference to the actual subjective views of the target company directors in that position. Directors have to be careful to avoid prejudging the capacity of their company's shareholders to assimilate complex information. The responsibility rests with directors to provide information in a form which allows shareholders the opportunity to understand and interpret it for themselves.
- The issue of materiality also requires an assessment as to whether the offerees would give some relative weight to the particular item of information, and include it as one of a number of factors to be considered, when determining whether to accept or reject the offer. The particular item of information on its own does not have to be so significant as to be likely to determine an accept/reject decision one way or the other, but nor should it be so insignificant as to have no bearing on such a decision.
- Particular care is required where the information is forward-looking and relates to or assumes a state of affairs which may or may not eventuate. Directors must assess the potential impact of the information on the decision of shareholders to accept or reject an offer and consider whether disclosure is appropriate.

It was common ground between the parties that Oyster Bay's vineyard assets had an unencumbered market value (assuming a scenario without the long term contracts in place) of the order of \$90 million, resulting in a net tangible asset assessment of Oyster Bay's shares at above \$8.00 per share in June 2005 on that basis.

The factors which the Panel considered to be material to its deliberations on these matters included:

- the unencumbered market value of Oyster Bay's vineyard assets of \$90 million implies a net tangible asset amount of Oyster Bay of \$8.00 per share, significantly above Delegat's offer price of \$4.00 per share;
- Delegat's had stated that long-term security of grape supply was important and that it did not intend to withdraw from its contractual arrangements with Oyster Bay;
- there was evidence that major international breweries and wine-making companies were interested in securing grape supply by acquiring New Zealand vineyards and appeared to be influencing the rising price of vineyard properties in Marlborough and elsewhere;

- one of the "Key Features" of the investment, as promoted in Oyster Bay's original 1999 prospectus, was:

Benefit from the value of the underlying properties. The net asset value per share (as per Logan Stone valuations) will be \$1.04 per \$1 invested upon subscription. Prime Wairau Valley viticultural land has appreciated strongly in value since 1995.

- Oyster Bay's reported vineyard asset values have declined between the 2001 and 2004 Annual Reports against a background of increasing land values in Marlborough during the same period;
- the nature of the contractual arrangements with Delegat's suggests that it would be extremely unlikely that Oyster Bay could sell its vineyard assets on an unencumbered basis;
- if Delegat's obtains majority voting control of Oyster Bay it could potentially control the composition of the board, making it even less likely that Oyster Bay would initiate moves to sell the vineyard assets or unwind the long term contracts; and
- if Delegat's obtains majority control, and in the absence of information about unencumbered market value, there was greater potential for value transfer if Delegat's were to acquire further shares by way of the "creep" provisions of the Code in future years at share prices that are reflective more of income-based valuations than of vineyard market valuations.

On the basis of this analysis, and having regard to the evidence available to it, the Panel decided that information about the market value, encumbered or unencumbered, of Oyster Bay's freehold and leasehold vineyards could reasonably be expected to be material to the making of a decision by Oyster Bay shareholders to accept or reject the Delegat's offer.

The Panel determined that it was not satisfied that Oyster Bay had complied with the Code in that the target company statement omitted information (relating to the market value, encumbered and unencumbered, of Oyster Bay's freehold and leasehold vineyards) that could reasonably have been expected to be material to the making of a decision by Oyster Bay shareholders to accept or reject the Delegat's offer.

In the subsequent Court proceedings the High Court endorsed the Panel's approach to materiality. Miller J said, "I have reached the clear view that the encumbered and unencumbered values of the vineyards was information that could reasonably be expected to be material to shareholders." He also said, "I have concluded that the Panel was entitled to conclude that [the encumbered and unencumbered values of the vineyards] might reasonably be expected to be material to shareholders. For the same reasons, I am satisfied that Oyster Bay has failed to comply with rule 46 of the Code ..."

When this commentary was prepared the matter was still before the High Court as to the appropriate orders to be made as a consequence of the Court's finding that Oyster Bay had failed to comply with Rule 46 of the Code.

Update on exemptions

CONVERSION OF EQUITY SECURITIES ACQUIRED UNDER A TAKEOVER OFFER

The Code requires that a full takeover offer include an offer for all classes of equity securities in the target company. In some cases a bidder who acquires convertible securities under a takeover offer may have to comply further with the Code to obtain the benefit of the rights attached to those securities. This situation arose during the full takeover offer for Urbus Properties Limited by ING Property Trust Management Limited.

Urbus had on issue ordinary shares and non-voting convertible notes. The convertible notes were equity securities for the purposes of the Code as they carried rights to acquire Urbus shares. Note holders could exercise the rights on certain dates or when certain events occurred, including a takeover offer.

Accordingly ING Property's offer for Urbus shares had to include an offer for the convertible notes. Note holders wishing to accept ING Property's takeover offer could either accept the offer for their convertible notes or exercise the conversion right attached to the notes and then accept the offer in respect of the resulting shares. When note holders accepted the offer for convertible notes (rather than post-conversion shares) ING Property would become the holder of those convertible notes.

As note holders ING Property had the right to convert their notes on various maturity dates. However, if the offer resulted in ING Property having more than 50% but less than 90% of the voting rights in Urbus, ING Property would require shareholder approval to convert the notes into ordinary shares (under rule 7(d) of the Code) because this would increase its control percentage in a manner that did not comply with the Code.

ING Property was, therefore, in the position that it was obliged under the Code to include an offer for the convertible notes issued by Urbus in its full takeover offer; and yet the Code would not permit ING Property to convert any notes so acquired, without shareholder approval. In effect ING Property would be required to comply with the Code twice before obtaining the voting rights attached to the convertible notes.

The Panel granted an exemption to allow ING Property to convert any convertible notes it acquired under the offer without obtaining the approval of shareholders. The Panel noted that:

- by exercising the conversion rights of the notes it acquired under the offer, ING Property would have the same level of voting rights in Urbus which it would have had if Urbus note holders had converted their notes into Urbus shares and then accepted the offer;

- in full takeover offers the level of control percentage which the offeror obtains is determined by the level of acceptances under the offer and not by shareholder vote.

It is inherent in the Code that, as a bidder is required to include an offer for all classes of equity securities issued by a target company in a full takeover offer, it should be entitled to the benefit of the rights attached to those securities, including the future acquisition of voting rights, without further complying with the Code. In some situations exemptions may be needed to give offerors the full benefit of the rights attached to securities acquired under a takeover offer.

Update on associates

CALGARY PETROLEUM LIMITED

The issue of association was considered in the section 32 meeting concerning Dorchester Pacific Limited which was the subject of a detailed article in *Code Word* 14. The issue has been considered further in a section 32 meeting concerning Calgary Petroleum Limited.

Persons who act jointly or in concert are associates. If one person acts or is accustomed to act in accordance with the wishes of another person they are associates. Related companies are associates. Parties that have a business, personal or ownership relationship will not necessarily be associates for the purposes of the Code. To determine whether such parties are associated the Panel considers all facets of the relationship and all the circumstances surrounding the relationship. A relationship is likely to be considered an association for Code purposes where it concerns the future control of voting rights of the code company.

In the Dorchester case the Panel determined that Bridgecorp Capital Limited and Brent King were associates because they had an ongoing contractual relationship relating to the future control of voting rights in Dorchester. Bridgecorp acquired 19.99% of the voting rights in Dorchester from a number of parties including Brent King. Mr King retained 5.05% of Dorchester. Bridgecorp and King considered that they did not breach the Code on the basis that they were not associates and neither held more than 20% of Dorchester. However, the Panel determined that they were associates because the agreements between them created ongoing relationships respecting the control of Dorchester. As associates their combined holdings exceeded the permitted threshold of 20%.

This was quite different from the situation in the Calgary case. In that case a number of shareholders increased their voting rights in Calgary by taking up an over-acceptance facility of a pro rata offer. Another shareholder complained to the Panel that these shareholders were associates because they had personal and business relationships, and had voted the same way on a resolution to remove a director of the company. The Panel decided that a number of shareholders agreeing to exercise their votes in a particular way does not necessarily make them associates. The Panel considered the nature of the relationship between the shareholders and determined that they were not associated. Although many of the shareholders had personal and business relationships, in contrast to the Dorchester case, their relationships did not involve the control of voting rights in Calgary.

It should be remembered that associate status of itself is not a breach of the Code. It is only if an associate becomes the holder or controller of voting rights, and together the associates hold, or will hold, more than 20% of the total voting rights in the code company, that the Code will be breached. In the case of Dorchester the fact that Bridgecorp and King were associates did not breach the Code. It was the acquisition that took their combined holding to more than 20% of Dorchester when they were associates, that breached the Code.

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