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THIS ISSUE OF *CODE WORD* FOLLOWS THE OYSTER BAY CASE THROUGH TO ITS CONCLUSION IN THE HIGH COURT AND THE START OF A NEW TAKEOVER PROCESS.

THIS CASE IS PARTICULARLY IMPORTANT AS IT HIGHLIGHTS THE ROLE OF DIRECTORS IN PREPARING THE TARGET COMPANY STATEMENT AND THEIR RESPONSIBILITIES IN FULFILLING THAT ROLE.

The Oyster Bay Case

Code Word No. 15 (November 2005) reported the first part of the protracted process for control of Oyster Bay Marlborough Vineyards Limited.

TO RECAP

The competitive takeover for Oyster Bay started in May 2005. It was initiated by Peter Yealands Investments Limited, the holder of some 6.7% of the shares in Oyster Bay. On 7 June 2005 Yealands made a partial offer to obtain enough shares to hold 51.1% of the shares of Oyster Bay. Delegat's Wine Estate Limited, who already held 32.58% of Oyster Bay, made a counter-bid on 7 July 2005 to attain 50.1% of the voting rights. As well as being a shareholder, Delegat's was party to very long-term contracts with Oyster Bay for the development and management of the vineyards and for the purchase each year of Oyster Bay's entire grape harvest.

The Delegat's bid reached the minimum acceptance level. However, Yealands and another Oyster Bay shareholder, Mr David Rankin, made complaints to the Panel relating to valuations of the vineyards, in particular the omission of reference to the value of the land excluding the effect of the various contracts with Delegat's (the unencumbered value).

At a section 32 meeting the Panel determined that it was not satisfied that Oyster Bay had complied with the Code by issuing its target company statement without the unencumbered valuation information. The Panel restrained Delegat's from declaring its offer unconditional and from acquiring any shares of Oyster Bay pursuant to its offer.

The Panel put forward a "preferred solution" which was to issue an agreed correcting statement and give accepting shareholders the right to cancel their acceptances of the Delegat's offer.

Delegat's initiated action in the Wellington High Court seeking to have the Panel's restraining orders set aside. Delegat's also wrote to all accepting shareholders giving its version of the land valuation issue, and inviting them to withdraw their acceptances or express support for the bid proceeding.

The Panel initiated proceedings against Delegat's and Oyster Bay seeking new interim restraining orders from the Court. After a hearing on 7 October 2005 Justice Miller said "... *I am satisfied that Oyster Bay has failed to comply with R46 of the Code and that the interim orders that the Panel seeks should be granted.*"

OYSTER BAY PART 2

At the High Court proceedings Yealands and Rankin supported the Panel's request for the extension of interim restraining orders but asked the Court to void Delegat's bid and require the takeover process to start again.

The Court held the final hearing on 28 November 2005 after a hearing on 9 November to deal with a number of procedural issues. From the exchange of documents ahead of the 28 November fixture all parties were aware that Logan Stone had provided new 2005 vineyard valuations to Oyster Bay on 10 July 2005 but these had not been provided to Ferrier Hodgson or the directors of Oyster Bay before the target company statement was finalised on 19 July 2005.

Before the hearing Ferrier Hodgson told the Panel that, had it known of the 2005 valuations, it would have calculated a higher NTA valuation of Oyster Bay (\$3.98 as against \$3.26) and could have revised its primary valuation (on a DCF basis) upwards. This would have meant that the final offer price of \$4 per share would no longer have appeared to be at a premium above valuation.

Miller J invited the Panel to make a recommendation to the Court under section 38 of the Takeovers Act. In that recommendation the Panel said it would no longer be asking the Court for orders to enable its “preferred solution” to be implemented. The Panel said that this decision was based on the issues that had recently arisen. In addition to the original breach, there was the failure to incorporate the 2005 valuations in the target company statement and independent adviser’s report. Also Yealands had given an undertaking to the Court that it would make a fresh bid at \$4.50 per share, but only if the Delegat’s offer was voided. The combination of these and other factors meant that the only appropriate course was to void the Delegat’s takeover offer and restart the takeover. This would leave Yealands under an obligation to make another offer for Oyster Bay and it would be up to Delegat’s to decide whether it would also make a fresh bid.

Miller J said in his judgment of 28 November 2005 (Takeovers Panel v Delegat’s Wine Estate Limited (No 3)(Unreported, HC Wellington, Miller J, CIV-2005-485-2058)) that he was “*satisfied that the 2005 Logan Stone valuation ought to have been disclosed as being material to shareholders. It would have altered Ferrier Hodgson’s conclusion that at \$3.50 both offers were fair; and of course it would have altered the independent directors’ advice that shareholders were being offered a premium for control.*”

His Honour said he remained of the view that “*... the difference between the unencumbered value and the Logan Stone ‘value in use’ DCF valuation could reasonably be expected to be material in circumstances where shareholders were considering two partial offers, one of which was from Delegat’s.* He concluded that “*... the Code was contravened by the omission of information that could reasonably be expected to be material to shareholders, in the form of unencumbered vineyard values and the 2005 Logan Stone valuation*”.

The judgment said that, even on the affidavit evidence for Oyster Bay, it was possible to say that “*... the standard of care required by the Code was not observed. Those signing the certificate [in the target company statement] were not in a position to express the view that information in the Target Company Statement was true and correct and not misleading, by omission or otherwise. Proper enquiries had not been made to identify the information that was reasonably likely to be material to shareholders, and to ensure it remained accurate as at the date of the Statement.*”

His Honour noted that Delegat’s had a considerable advantage, even if the contracts were made voidable at the shareholders’ option, because it had won the takeover contest. He said that he was satisfied that “*... Delegat’s would not have enjoyed the same advantage had the 2005 valuation and the unencumbered vineyards value been disclosed on 19 July*”

After discussing the impact on shareholders, who had sold to Delegat’s for only \$4 per share, the judgment concluded that Oyster Bay’s breach went to the heart of Delegat’s offer. His

Honour said that he “*... agree[d] with the Panel’s view that the process was too seriously flawed to allow it to stand, and the deficiencies [could not] be remedied by means of a corrective statement.*” He accepted the Panel’s recommendation that the Delegat’s offer be voided.

The Court exercised its powers to void the Delegat’s offer and require the takeover process to start again.

Yealands announced that it would act on its undertaking to make a new partial offer of at least \$4.50 per share by mid-December. Subsequently Delegat’s gave notice of intention to make a further partial offer at \$5 per share. Shortly afterwards Yealands and Delegat’s reached an arrangement whereby Delegat’s made a partial offer at \$6 per share and Yealands agreed to accept that offer. Yealands was released from the undertaking it had given the Court to make a new offer at a minimum of \$4.50 per share.

COMMENTARY

The Oyster Bay case emphasises the importance of the role of directors in preparing the target company statement and the care needed to fulfil that role.

In preparing the target company statement directors must consider all relevant information about the assets, liabilities, prospects and affairs of the target company that could reasonably be expected to influence a shareholder’s decision on whether or not to accept a particular bid, and ensure all such information is disclosed. Directors must be very careful not to prejudice shareholders’ ability to assimilate complex information. Directors are responsible for providing information in a form which shareholders can understand and interpret.

It is also vital that directors and the independent adviser ensure that they have the most up-to-date information.

The Court has shown that where breaches of the Code relating to a target company statement are serious it will use its powers to void a takeover and force a restart of the takeover.

The Panel is pleased with the outcome of the Oyster Bay litigation, but it prefers to avoid recourse to the Courts. The Panel prefers to facilitate the takeover process but will, where necessary, seek appropriate orders from the Court when the Code is breached.

Rank Group Investments & Carter Holt Harvey

The Panel made a significant decision in February 2006 on the terms of a proposed offer to be made by Rank Group for the remaining shares in Carter Holt Harvey it did not hold.

Rank Group had made a protracted takeover bid for Carter Holt, including the acquisition of the controlling stake sold by United States company International Paper. When the offer closed on 27 January 2006 Rank Group had 85.7% of the shares of Carter Holt.

On 3 February 2006 Rank Group gave notice of a further takeover offer for Carter Holt. This is permitted under the Code. The proposed terms of the offer were a base consideration of \$2.70 per share, with an additional 5¢ per share payable to all acceptors if sufficient acceptances were received within 7 business days of the date of the offer, for Rank Group to reach the 90% compulsory acquisition threshold.

Rule 24(2) of the Code requires that an offer be open for a minimum of 30 days. The Panel was concerned that Rank Group's proposed offer did not comply with this requirement and sought submissions from Rank Group's legal advisers. On 8 February the Panel convened a meeting under section 32 of the Act to be held on 13 February 2006. Further submissions were received at that meeting.

The Panel issued its determination on 15 February 2006. It said that the limiting terms of the proposed offer, in respect of the full offer price of \$2.75, in effect shortened the period for shareholders to consider the whole offer from the required 30 calendar days to 7 business days from the date of the offer.

Neither would the offer comply with rule 24(1) as the offer in its entirety would, in effect, not be open for the 30 day offer period specified in the offer document.

To remedy the breach the Panel accepted an enforceable undertaking from Rank Group to amend its proposed offer to a straight offer at \$2.75 per share with no conditions requiring early acceptance of the offer.

This was an important decision for the future makeup of Code offers. The Code is an enhanced participation regime. It is designed to ensure that all shareholders take part in the takeover process. To help achieve this a takeover offer must have provisions to ensure that shareholders:

- have sufficient information on which to determine the merits of a takeover offer; and
- have a reasonable time in which to receive and consider the information and weigh up the merits of the offer.

Rank's proposed offer sought to avoid the second of these key requirements.

Guidance Note - Restrictive Conditions

The Code allows a bidder to make a takeover offer subject to conditions but limits the nature of those conditions. Rule 25(1) of the Code provides that:

“An offer may be subject to any conditions, except those that depend on the judgement of the offeror or any associate of the offeror; or the fulfilment of which is in the power; or under the control, of the offeror or any associate of the offeror.”

The purpose of the limitation in rule 25(1) is to promote a level of certainty in takeover offers and prevent an offeror

from circumventing the provisions of the Code preventing the withdrawal of an offer.

Recently the Panel has seen an increase in offer conditions which restrict the business activities of the target company during the period of the offer.

There may be legitimate reasons for some restrictions on the business activities of the target company during an offer. For example, an offer condition may restrict the target company from entering into a major transaction. In many cases this condition is appropriate as it protects an offeror who, having made an offer for a company, finds that the company's business has changed significantly during the offer period.

If the directors of the target company ignore conditions relating to the business activities of the target company they run the risk that their actions constitute a defensive tactic under rule 38 of the Code. Rule 38 of the Code provides that:

“If a takeover notice has been received, or the directors of a target company have reason to believe that a bona fide offer is imminent, the directors must not take or permit any action in relation to the affairs of the company that could effectively result in an offer being frustrated or the shareholders being denied an opportunity to decide on the merits of an offer.”

If an offer is conditional on specified events occurring or not occurring, and the target company directors take action relating to the target company which means a condition cannot be satisfied, the action by the directors could arguably be seen as a defensive tactic.

Target company directors who want to take an action that runs the risk of constituting a defensive tactic can, under rule 39 of the Code, have the action approved by an ordinary resolution of the target company or seek prior approval of the proposed action from the Panel.

Obtaining approval under rule 39 protects the directors of the target company from a breach of rule 38 of the Code. However, it would not alter the fact that a condition of an offer will not be satisfied, thus providing the offeror with a right to withdraw the offer.

If an offer condition is so restrictive that it prevents a target company from undertaking activities that are part of its ordinary business, different considerations apply. The Panel's view is that this type of offer condition is likely to breach rule 25(1). It is almost inevitable that a condition of this type will be breached if the target company carries on its ordinary business. As a consequence the condition can only be fulfilled by the offeror waiving the condition. In effect the offeror controls the fulfilment of the condition which is not permitted by rule 25(1).

Consequently offers imposing unreasonable restrictive conditions face the prospect of being challenged because the condition breaches rule 25(1).

Schemes of Arrangement & Inconsistencies Between the Code & the Companies Act

The Panel has released a discussion paper on proposed changes to its policy on the use of its exemption powers to enable changes of control of Code companies using schemes of arrangement under Part XV of the Companies Act 1993.

The paper also discusses the relationship between the Code and the Companies Act in respect of schemes of arrangement.

The Panel has watched with interest the proposed amalgamation of Waste Management NZ Limited and Transpacific Industries Group Limited under Part XIII of the Companies Act. This use of the amalgamation provisions in the Companies Act raises similar concerns to those raised in the Panel's discussion paper on schemes of arrangement.

The Panel will carefully consider the issues arising out of the relationship between Parts XIII and XV of the Companies Act and the Takeovers Code as part of its function to keep the law relating to takeovers of Code companies under review.

Misleading the Panel

The Panel is concerned about incompleteness and lack of accuracy in some information it receives. These shortcomings occur both in complaints about the behaviour or actions of others and in exemption applications.

The Panel has powers which can influence the outcome of a takeover. Among the most important are powers enabling the Panel to investigate and take action on suspected breaches of the Code (section 32 of the Takeovers Act) and powers to grant exemptions from the Code (section 45 of the Act).

The Panel can take enforcement action in various ways and for a number of different reasons.

The Panel may take action on its own initiative, or may act on a complaint from a party to a takeover or potential takeover against the actions or suspected actions of another party. A party can complain to the Panel through either:

- a letter describing the alleged breach of the Code by the other party, and asking the Panel to investigate the matter; or
- a formal request under section 35 of the Act that the Panel convene a meeting under section 32 to determine the matter.

The Panel takes all complaints seriously. It expects complainants to give full and frank disclosure of their position in, or

relationship to, the person or activity complained of. If the complainant's own behaviour or actions are material to the resolution of the complaint then the Panel expects complete disclosure of any relevant behaviour or actions.

It is a serious matter for the Panel to intervene in the market. It has strong statutory powers including power to:

- issue restraining orders;
- obtain documents under summons; and
- compel people by summons to attend its meetings and answer questions put to them (generally on oath).

When the Panel initiates an investigation or inquiry, on its own account or in response to a complaint, the investigation or inquiry has the potential to impose considerable costs on the party that is its subject. It may also disturb and disrupt the market.

Some complaints are made for tactical purposes. Whatever the purpose, the complainant should take care to disclose all relevant facts to the Panel, even if some of those facts do not assist the complaint. Failure to provide such information is likely to be considered by the Panel as game-playing at best. At worst the Panel may conclude it has been intentionally misled.

The same disclosure requirements apply to applications for Panel exemptions. During a takeover a Panel exemption may affect the rights of parties in significant and different ways. It is therefore vital that the Panel knows all the relevant facts and circumstances when deciding whether to grant an exemption and, if an exemption is granted, on what terms.

The Panel believes that some applicants for exemptions have not provided full and complete information in their applications. For example, exemptions may be sought for particular aspects of a transaction when other aspects of the transaction, also requiring a Panel exemption, are not disclosed when the first exemption is sought. Sometimes the likely outcomes of certain events are exaggerated for effect.

Under section 44 of the Act it is a criminal offence to furnish information or produce a document to, or give evidence at a meeting of, the Panel knowing it to be false or misleading, or to attempt to deceive or knowingly mislead the Panel in relation to any matter before it. This reflects the statutory nature of the Panel's processes, and underscores the importance of making full and frank disclosure to the Panel in all matters.

It is important for the efficient operation of the takeovers market that participants always fulfil their responsibility to provide complete and accurate information to the Panel.

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