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# Code Word



TAKEOVERS PANEL

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## New Rule 64 – misleading or deceptive conduct

The new rule 64 of the Takeovers Code prohibits misleading or deceptive conduct in relation to Code-regulated transactions. Market participants need to be aware that when this conduct occurs the Panel will respond in an appropriate manner to protect the interests of the market.

### Prohibition against misleading or deceptive conduct

The prohibition in rule 64 of the Code against misleading or deceptive conduct during Code-regulated transactions comes into force on 29 February 2008. New sections 44B to 44E of the Takeovers Act (which also relate to misleading conduct) will come into force at the same time.

Rule 64 provides:

- (1) A person must not engage in conduct that is –
  - (a) conduct in relation to any transaction or event that is regulated by the Code; and
  - (b) misleading or deceptive or likely to mislead or deceive.
- (2) A person must not engage in conduct that is –
  - (a) incidental or preliminary to a transaction or event that is or is likely to be regulated by the Code; and
  - (b) misleading or deceptive or likely to mislead or deceive.

Rule 64 enables the Panel to exercise its enforcement powers for any misleading or deceptive conduct relating to Code-regulated transactions or events. Misleading or deceptive conduct that is incidental or preliminary to transactions or events that are, or are likely to be, regulated

by the Code, will also be subject to the Panel's enforcement powers.

Rule 64 applies to any person – not just to bidders or target companies or major shareholders. Any person who engages in misleading or deceptive conduct relating to a Code-regulated transaction or event is caught by the prohibition.

As well as the rule 64 prohibition, it will also be a criminal offence, under new section 44C of the Takeovers Act, to make or disseminate materially false or misleading statements or information relating to Code-regulated transactions or events. The penalties for this offence are, for an individual, imprisonment for up to five years or a fine of up to \$300,000, or both. For a body corporate, a fine of up to \$1 million can be imposed.

### Meaning of misleading or deceptive conduct

Rule 64 has broad application. It is based on section 9 of the Fair Trading Act 1986 which prohibits misleading and deceptive conduct in trade.

The term 'misleading or deceptive' has been subject to wide judicial consideration over many years in many cases in New Zealand and Australia. It appears frequently in

consumer protection legislation (such as the Fair Trading Act and the Australian Trade Practices Act 1974). The term also occurs in the market manipulation provisions of the Australian Corporations Act 2001.

An analysis of Australian case law indicates that the Courts in Australia apply the consumer protection tests and reasoning to market manipulation cases. It is reasonable to believe that the same would occur in New Zealand Courts.

The Panel intends to construe the words ‘misleading’ and ‘deceptive’ in the same way as the New Zealand and Australian Courts. They will be given their natural and ordinary meaning of ‘to lead into error’. Accordingly, the Panel will consider Code-related conduct to be misleading or deceptive if it leads, or would be likely to lead, persons into error.

When these new provisions come into force, the Fair Trading Act will no longer apply to conduct regulated by the Code and the Takeovers Act. This enhances the Panel’s role as the primary regulator of changes of control in Code companies.

### **Panel will take enforcement action against misleading or deceptive conduct**

Market participants involved in a takeover or other Code-related transaction should always take care if they make any representations to the media or to the market. This will be even more important when rule 64 is operative. When misleading or deceptive conduct takes place during a Code-related transaction or event, the Panel will respond in an appropriate manner to protect the interests of the market.

### **How the Panel will deal with ‘last and final statements’**

Parties involved in a takeover often make announcements about their intentions for the takeover. These statements are made to influence other parties to the takeover and are described generically by takeover regulators as ‘last and final statements’.

Statements by an offeror, such as “[Offeror Ltd] will not increase the offer price”, or “[Offeror Ltd] will not extend the offer period” are last and final statements. At times, major shareholders in a target company will make announcements

about their intentions, such as “[Shareholding Company Ltd] does not intend to accept the offer”. Any later inconsistent action or statement risks breaching rule 64. The Panel will rigorously enforce the prohibition against misleading or deceptive conduct.

The integrity of the market requires that statements made in relation to takeovers can be relied on. For that reason, last and final statements must be adhered to as to a promise. The Panel intends to enforce those promises.

### **Last and final statements must be qualified or adhered to strictly**

Last and final statements may be qualified when they are made, in order to preserve the right to depart from the statement. However, such qualifications must be clear and unequivocal. For example, “At present [Offeror Ltd] does not intend to increase the offer price, but it reserves the right to do so,” is a clearly qualified statement.

As a matter of practice, the Panel will write to those who make last and final statements at the time of their publication or when drawn to the Panel’s attention. If the statement is unqualified, the Panel will ask whether an unqualified statement is what was really intended. If it was not intended to be an unqualified statement, the person will be invited to promptly publish a qualification to the statement.

The person will be put on notice that unqualified statements must be adhered to. If the statement is equivocally qualified, the Panel will invite the person to clarify their position to the market and to the Panel immediately.

If clearly misleading conduct occurs, such as departing from the terms of an unqualified last and final statement, and the parties involved are not prepared or are not able to correct that conduct, the Panel is likely to call a meeting under section 32 of the Takeovers Act (which gives the Panel its principal enforcement powers). In these circumstances the Panel may give just 24 or 48 hours notice of the meeting. The Panel’s intention for calling these meetings with short periods of notice is to ensure that any misinformation in the market, which is misleading or deceptive or is likely to mislead or deceive, is corrected promptly.

Restraining orders and compliance orders are likely to be made by the Panel where there has been a departure from a last and final statement. Court orders will be sought if any transactions require unwinding. The Panel believes that the integrity of information in the market must be upheld, so that market participants can rely on that information. Those who make last and final statements should be held to the terms of those statements.

### **Remedies for misleading or deceptive conduct**

When the Panel determines that a breach of rule 64 has occurred, any remedy the Panel orders will be balanced between providing certainty for the market and achieving the appropriate commercial outcome. The Panel is likely to require those who make last and final statements to act in accordance with those statements and to promptly correct any misinformation.

Keeping a takeover bid on track is likely to be at the forefront of the Panel’s reasoning for the remedies put in place. However, in some cases it may be more appropriate to stop a bid from proceeding. The Panel will consider every case on its merits.

The Panel has new powers to require corrective statements to be published, without having to obtain Court orders. The Panel can also prohibit people from making statements or distributing documents. The remedies and penalties available through the Court have also been extended (see Code Word 17).

The Panel may seek pecuniary penalties against company directors who knowingly are involved in a company’s misleading conduct. A director who incurs a pecuniary penalty is also automatically banned for five years from managing a New Zealand company.

### **Panel does not want its resources wasted**

In a contest for control of a Code company, or where a takeover is opposed, parties often look for an opportunity to complain to regulators. Because of the likelihood of tactical complaints being made in these circumstances, and also to

manage its enforcement resources efficiently and responsibly, the Panel may apply threshold tests to decide whether to act on a complaint about misleading or deceptive conduct.

A departure from an unqualified last and final statement is likely to be seen as misleading or deceptive conduct, and the Panel will take prompt action on such departures. However, the question as to whether other Code-related conduct is misleading or deceptive or is likely to mislead or deceive may be less clear.

To enable the Panel to use its enforcement resources most effectively complainants may have to do more than merely complain to the Panel.

The Panel dislikes being drawn into a takeover contest through tit-for-tat complaints. Protagonists in a contested or hostile takeover must convince the Panel that its resources would be properly used if it acts on their complaint. For example, the complainant may be required to show that it has a prima facie case, or that the complaint is not vexatious, or to establish that there would be merit in the Panel’s acting on the complaint.

A complainant’s formal request that the Panel convene a section 32 meeting to determine whether there has been a breach of the Code is always taken very seriously by the Panel. However, complainants should be aware that they may have to pay the Panel’s expenses if, as a result of a section 32 meeting, the Panel determines that the Code has not been breached.

### **Take care when making public statements**

A note of caution for anyone making public statements about Code-related transactions or events: under rule 64 no element of intention to mislead or deceive is required. Think carefully about words and actions and how others may perceive them.

Conduct may be found to be misleading or deceptive even if it was not intended to mislead or deceive. It still may unintentionally lead persons into error. However, if a person is found to have deliberately misled or deceived market participants, the remedies sought by the Panel are more likely to include pecuniary penalties.

# Conditional acceptance facilities can provide flexibility

Conditional acceptance facilities enable shareholders to conditionally accept an offer. However, offerors need to take care to meet all of the Code's requirements, including rule 64.

## Offering a conditional acceptance facility

A conditional acceptance facility can be included in the terms of a takeover offer made under the Takeovers Code. Under such a facility, conditional acceptances are generally held in 'escrow', that is, by a third party until certain conditions are met. Usually, the condition which has to be satisfied to trigger the actual acceptance, will be the offer reaching a particular acceptance threshold such as more than 50% (or a lesser percentage for a partial offer approved under rule 10) or 90% of the shares in the target company.

Offers that include a 90% minimum acceptance condition that cannot be waived can languish if shareholders are unwilling to commit their shares. This may be because of the risk of the shares being locked into the bid for a long time when there is no guarantee that the bid will succeed. Similarly, if an offer is contested, shareholders may be unwilling to accept either offer because of the risk that their shares are locked into the losing bid and they can't then accept into the winner's bid. These are situations where having a conditional acceptance facility can provide flexibility for shareholders and, as a result, the bid can be more attractive.

An offer that is languishing can cause inconvenience to many parties, including the bidder. The bidder may not be in a position to increase the offer price to encourage shareholders to take up the offer. However, once the offer has been made, the Code does not allow an offeror to simply change its mind and withdraw the offer. This provides certainty for the target company and its shareholders that the offer will run its course.

Rule 26 of the Code sets out a process for offers to be withdrawn with the consent of the Panel. However, the Panel is unlikely to consent to an offer being withdrawn in a contested takeover while all the competing offers are still capable of succeeding (i.e., while no offeror has yet received sufficient acceptances to meet the Code's minimum acceptance threshold of more than 50%).

In a relatively recent case a takeover was contested but the second offeror was gaining few acceptances. Both offers had

a minimum acceptance condition of more than 50% of the target company shares (as is required by the Code). The one that made it over the threshold first would win the 'contest', and the other offeror's offer must fail.

Towards the end of the offer period, the second offeror applied to the Panel under rule 26 of the Code. The applicant wanted the Panel's conditional consent to withdrawing the offer, if it became clear that the minimum level of acceptances needed for its offer to succeed would not be achieved.

The Panel declined the application. The first offeror had not at that time received sufficient acceptances to take it over the minimum acceptance condition threshold, so it was possible that either offer could still succeed.

If the Panel had given the conditional consent sought by the second offeror it would, in effect, be a variation of the offer. This is not permissible under rule 27 of the Code. Rule 27 allows an offer to be varied only:

- to change the consideration payable; or
- to extend the offer period and the date by which the offer is to become unconditional.

The Panel's consent would have given the second offeror an advantage over the first offeror, by creating a non-permissible variation to the second offeror's offer. The effect would have been similar to allowing the second offeror to vary its offer by including a conditional acceptance facility in its offer terms.

The Panel considers that the Code does not prevent conditional acceptance facilities being included in the offer terms when a takeover offer is made, if the facility is available to all shareholders and complies with rule 20. Rule 20 requires that an offer be made on the same terms and provide the same consideration for all securities in each class under offer.

If a conditional acceptance facility is included in the terms of an offer, details about how the facility would operate must be clearly explained in the offer document. Disclosures made during the offer period about the number of shares that have been accepted under the facility must be clear and accurate.

Rule 49A of the Code requires the offeror to give written notice to the Panel and the target company (and the Exchange if the offeror or the target is a listed company) in writing every time the level of acceptances received for each class of securities increases by 1% or more.<sup>1</sup> Disclosures about the level of acceptances received under the offer should clearly state the percentage of acceptances that are irrevocable, and the percentage received under the conditional acceptance facility.

<sup>1</sup> Rule 49A was introduced under the Takeovers Code Approval Amendment Regulations 2007 on 1 July 2007

<sup>2</sup> New Rule 64 will come into force on 29 February 2008

Accuracy is critical in the disclosure of the level of acceptances received under a conditional acceptance facility. A failure to accurately disclose the level of acceptances received under a conditional acceptance facility and the level received directly into the offer could be regarded as being misleading or deceptive conduct in breach of rule 64.<sup>2</sup>

## Guidance Note

The meaning of 50 or more shareholders in the definition of Code company

### When is an unlisted company a Code company?

Code companies are companies that are subject to the rules of the Takeovers Code.

Listed companies with voting securities quoted on the NZSX or NZAX markets are Code companies. Unlisted companies with 50 or more shareholders are also Code companies.

The Panel has received enquiries about how to interpret the word *shareholders* when deciding whether an unlisted company falls within the definition of Code company in the Takeovers Code. This has been a more urgent question for some companies since the Takeovers Amendment Act 2006 removed the asset threshold from the definition.

The Code defines *code company*, in respect of unlisted companies, as a company that *has 50 or more shareholders*. Before the Takeovers Amendment Act 2006 was passed the words *and \$20,000,000 or more of assets* were included in that definition.

Neither the Code nor the Takeovers Act 1993 defines *shareholders*. The particular enquiry made of the Panel has been whether each individual shareholder in the company should be counted, or whether the number of share parcels that are held should be counted, as *shareholders*.

These can result in different figures because some share parcels are held jointly, for example, by family members or by the trustees of a trust.

Each of the joint shareholders is required by the Companies Act 1993 to be named in the company's share register.

The Panel's view is that *shareholders* means each shareholder named in the company's share register. The Panel enforces the Code on that basis.

### Shareholders means shareholders

The Takeovers Act and Companies Act were passed in the same bundle of company law reforms. Since the takeovers law does not define shareholder (but does define company as having the meaning given by the Companies Act), the Panel considers that one must look to the Companies Act for the meaning of shareholder.

The Companies Act defines shareholder as having the meaning set out in section 96 of that Act, as follows:

#### Section 96 Meaning of "shareholder"

*In this Act, the term "shareholder", in relation to a company, means-*

- A person whose name is entered in the share register as the holder for the time being of one or more shares in the company:*
- Until the person's name is entered in the share register, a person named as a shareholder in an application for the registration of a company at the time of registration of the company:*
- Until the person's name is entered in the share register, a person who is entitled to have that person's name entered in the share register under a registered amalgamation proposal as a shareholder in an amalgamated company.*

Thus, *shareholders* are the persons named in the company's share register (or entitled to be so). Section 96 of the Companies Act makes it plain that each joint shareholder (i.e. each person named or entitled to be named in a company's share register) must be counted when working out whether a company has 50 or more shareholders and therefore is a Code company. Joint shareholders each have their names entered in the company's share register, so each joint shareholder must be counted when assessing how many shareholders there are.

### ***Shareholders does not mean share parcels***

The Panel does not accept the argument, put by some on policy grounds, that the definition *50 or more shareholders* should be interpreted to mean that a company's voting securities must be held in 50 or more share parcels (by any number of persons) for a company to be a Code company.

The reason often given for this interpretation is that the Code is concerned with voting rights. The argument advanced is that, since each share carries only one vote, regardless of the number of joint holders of that share, *50 shareholders* must be intended to mean *the 50 shareholders that can exercise the votes attaching to the shares*.

This argument cannot be sustained. It ignores the definition in the Code for *code company* (which refers to *50 shareholders* and not to anything else) and the definition provided by section 96 of the Companies Act. Also it does not take into account that there is nothing in the Companies Act, the Takeovers Act or the Code that would limit the shares referred to in section 96 of the Companies Act to *voting securities*. Indeed, sections 36 and 37 of the Companies

Act establish quite clearly that a company can issue *shares* that do not confer voting rights (e.g. redeemable preference shares). The names of the holders of non-voting shares must be entered in the company's share register.

Accordingly, unlisted companies with 50 or more shareholders who hold any type of shares will be Code companies.

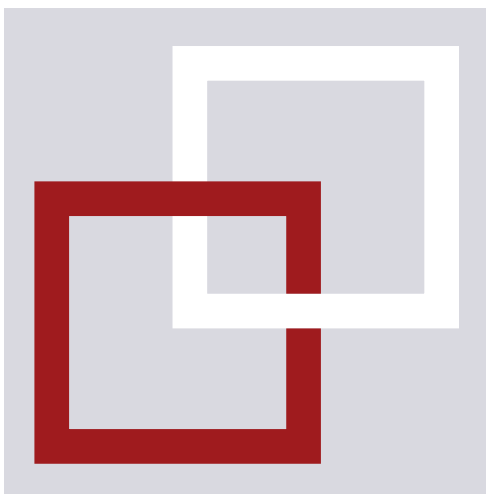
### **Avoiding double counting**

In some companies share parcels are held by trustees. Sometimes one person is the trustee of several trusts for which shares are held in the same company. The trustee (or any person) who holds several separate share parcels in the same company, being the *person whose name is entered in the share register* (Companies Act section 96), should be counted only once, when deciding if there are 50 or more shareholders.

A shareholder is a person who holds a share or shares. A person's shareholder status is not impacted by the number of shares they hold, or by whether they hold several share parcels in different capacities. Therefore, a company will be a Code company if it has 50 or more different persons named in the company's share register, regardless of the number of shares any of those persons holds and regardless of any different capacities in which they hold shares.

To illustrate this point in reverse, if the *share parcels* interpretation were adopted for the meaning of *50 or more shareholders* (an interpretation that is rejected by the Panel), then each parcel would have to be counted, even if several of the parcels were held by the same person acting as trustee of different trusts.

Shareholders means shareholders.



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