

SMALL CODE COMPANIES

Guidance Note



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**TAKEOVERS
PANEL**

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1 Introduction

- 1.1 This Guidance Note sets out the Panel’s experiences with inadvertent breaches of the Code involving smaller Code companies, what these companies can do to mitigate these issues, and what the Panel is doing, or can do, to assist these shareholders and companies. It also expresses the Panel’s view on the meaning of “shareholders”, for counting the number of shareholders of a company.

2 Code Companies

- 2.1 The Code applies only to “Code companies”. A company is a Code company if it is a New Zealand registered company that:
- (a) is a party to a listing agreement with a registered exchange and has securities that confer voting rights quoted on the registered exchange's securities market; or
 - (b) was within paragraph (a) at any time during the period of 12 months before a date or the occurrence of an event referred to in the Code; or
 - (c) has 50 or more shareholders (with voting rights) and 50 or more share parcels.
- 2.2 This Guidance Note is concerned with those companies which fall into category (c): unlisted Code companies.

Meaning of “shareholder”

- 2.3 Under the Companies Act 1993, *shareholder* means each shareholder named in the company’s share register (section 96). The Panel enforces the Code on that basis. Note that only shareholders whose shares confer voting rights should be counted.
- 2.4 In the case of joint shareholders (e.g., spouses or trustees of a family trust), the Panel’s view is that each joint shareholder must be counted when working out whether a company has 50 or more shareholders and therefore is a Code company (provided that it also has 50 or more share parcels). 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.
- 2.5 Double counting should be avoided. A shareholder is a person who holds a share or shares. If a person holds several share parcels in different capacities, that person only counts as one shareholder.

3 Class exemption for small Code companies

- 3.1 The Panel granted the [Takeovers Code \(Small Code Companies\) Exemption Notice 2016](#) for persons who increase their holding or control of voting rights in a small, unlisted Code company as a result of an allotment of voting securities by the Code company. For the purposes of the exemption, a company is “small” if its assets total \$20 million or less.
- 3.2 The exemption permits a small company to opt out of Code compliance. The exemption applies only if:
- (a) the company’s board has resolved that, in its opinion, opting out is in the best interests of the company;
 - (b) the company has given shareholders a disclosure document and an opportunity to object to the opt out and to require full Code compliance; and
 - (c) objections to the opt out represent less than 5% of the “free float” shares.
- 3.3 Free float in this context means the shares belonging to shareholders who are not relying on the exemption.

4 Why do small Code companies often run into difficulty with the Code?

- 4.1 Shareholders in a smaller Code company are often involved in the activities and operations of the company, or are connected to the history of the company in some way. The shareholders may be family members, existing or former employees, or persons with whom the company has a significant trading connection.
- 4.2 Also, many shareholders in smaller companies choose to protect their investment position through instruments like shareholders' agreements, or insist on mechanisms such as pre-emptive rights to ensure some control over the shareholder profile of the company.
- 4.3 The relationships between the shareholders in small companies, and the instruments and mechanisms used to protect their investment position, have the potential to trigger the "associate" provisions of the Code.

Associates

- 4.4 Rule 4 of the Code states that, for the purposes of the Code, a person is an associate of another person if:
- (a) the persons are acting jointly or in concert; or
 - (b) the first person acts, or is accustomed to act, in accordance with the wishes of the other person; or
 - (c) the persons are related companies; or
 - (d) the persons have a business relationship, personal relationship, or an ownership relationship such that they should, under the circumstances, be regarded as associates; or
 - (e) the first person is an associate of a third person who is an associate of the other person (in both cases under any of paragraphs (a) to (d)) and the nature of the relationships between the first person, the third person, and the other person (or any of them) is such that, under the circumstances, the first person should be regarded as an associate of the other person.
- 4.5 It will often be the types of relationships described in paragraph (d) above that shareholders in small Code companies have. This means that, due to the relationships or agreements made between shareholders in a small company, the shareholders may be considered to be associates of one another under rule 4 of the Code.
- 4.6 Shareholders being associates of one another is not necessarily problematic in itself; that is if the fundamental rule of the Code is adhered to (i.e., no person, together with their associates, increases their shareholding over 20%) and the compliance options in rule 7 of the Code are followed (i.e., takeover offers are made to all shareholders or by obtaining shareholder approval for an increase in shareholding).
- 4.7 However, if all or a majority of existing shareholders are associates then they will not be able to buy or transfer shares (other than through a Code offer) between themselves (because each shareholder, together with its associates would together hold or control more than 20% of the voting rights in the company), and if shareholder approval is sought for any acquisition or allotment of shares the acquirer, the disposer, the allottee and their respective associates would be excluded from voting on the question by rule 17. This means that if all of the shareholders are associated, then under the Code there is no one to vote on the resolutions required by rule 7 in order to move ahead with a proposed transaction.

- 4.8 A shareholders' agreement sets out rules and procedures for shareholders on matters relating to the company. The agreement can deal with any number of matters or just one or two major issues which the shareholders regard as important.
- 4.9 Generally, a shareholders' agreement is broken down into a number of parts, including:
- (a) entry into the company and the terms on which a person becomes a shareholder;
 - (b) governance and control of the company;
 - (c) exit arrangements;
 - (d) transfers of shares, including pre-emptive rights; and
 - (e) arrangements regarding the appointment of directors.
- 4.10 The Panel has in the past found that shareholders may be associates of one another by virtue of being parties to a shareholders' agreement (e.g., where shareholders agree to entrench their support for their respective nominees for directorships). In the absence of an exemption from the Code, shareholders may therefore not be able to increase their percentage of shares in the company (other than through a Code offer) or vote on resolutions to approve proposed acquisitions or allotments by other shareholders. The issue of association is discussed further below.

5 Association, Code compliance and exemptions

- 5.1 The Panel acknowledges that it is sometimes difficult for the shareholders in these smaller Code companies, because of the way these companies are traditionally structured, to comply with the provisions of the Code and that this fact can result in inadvertent breaches of the Code.
- 5.2 In June 2011, the Panel granted an exemption to all the minority shareholders in Ormiston Surgical & Endoscopy Limited (**Ormiston**) ([Takeovers Code \(Ormiston Surgical & Endoscopy Limited\) Exemption Notice 2011](#)).
- 5.3 Ormiston was proposing to issue voting securities to Southern Cross Hospitals Limited (**Southern Cross**). As Southern Cross already held and controlled more than 20% of the voting rights in Ormiston, it could only increase its voting control in Ormiston if shareholders first approved the proposed allotment by an ordinary resolution in accordance with rule 7(d) of the Code.
- 5.4 However, rule 17(2) of the Code prohibits the allottee and its associates from voting on a resolution for the approval of an allotment. The Panel considered that Ormiston's shareholders may all have been associates of Southern Cross by virtue of being parties to a shareholders' agreement, which, amongst other things, contained clauses concerning voting on board representation and pre-emptive rights. The shareholders of Ormiston therefore needed an exemption from compliance with rule 17(2) of the Code to enable them to vote on the resolution to approve the proposed allotment to Southern Cross.
- 5.5 The Panel granted the exemption to the shareholders on the understanding that they would unwind the shareholders' agreement and that they would vote on the resolution in any manner they thought fit. In other words, that they would "dis-associate" themselves from the requirements or influence of the shareholders' agreement.
- 5.6 The Panel considered that the exemption was appropriate and consistent with the objectives of the Code because:
- (a) all of the current shareholders of Ormiston may have been associates for the purposes of the Code due to their participation in the agreement and, as such, the mechanisms provided in the Code for the approval of Southern Cross's proposed increase of voting securities in Ormiston through the proposed allotment were unworkable; and

- (b) Ormiston provided a detailed enforceable undertaking under section 31T of the Takeovers Act 1993 to use all reasonable endeavours to seek the effective termination of the agreement as soon as practicable after the proposed allotment had taken place; and
- (c) the exemption provided Ormiston with the opportunity to make a reasonable transition to full compliance with the Code; and
- (d) Ormiston's shareholders had the opportunity to vote (on a fully informed basis) to approve Southern Cross's voting control increase; and
- (e) the exemption maintained a proper relationship between the costs of complying with the Code and the benefits resulting from it.

5.7 In line with the Ormiston exemption, the Panel may only grant such an exemption to a company if the company agrees to unwind the elements of association between the shareholders. For example, Ormiston undertook to use all reasonable endeavours to seek the effective termination of the shareholders' agreement as soon as practicable after the proposed allotment had taken place. Ormiston later confirmed to the Panel that the agreement had been terminated.

6 Implications for small Code companies

- 6.1 As described above, shareholders of smaller companies that are subject to the Code need to consider whether shareholders' agreements and other such instruments are necessary in the context of their company. If shareholders decide that such agreements are necessary they must be aware that these instruments may result in a possibility, or even a likelihood depending on the nature of the instrument, of there being an "association" between shareholders. This may consequently mean that there is no viable way for any shareholder in the company to increase their voting control in compliance with rules 7(c) and 7(d) of the Code.
- 6.2 For small Code companies, the Panel is not averse to the shareholders deciding to restructure their holdings so that they do not fall under the definition of Code company, provided that the restructuring is undertaken in a manner that complies with the Code.
- 6.3 The Panel executive is available to help and can explain the implications of the Code, whether an exemption might be necessary, and the matters that the Panel will consider for granting an exemption.