

**GUIDANCE NOTE ABOUT THE ROLE OF  
INDEPENDENT ADVISERS**

**FOR THE PURPOSES OF THE TAKEOVERS CODE**

**THIRD EDITION**

**TAKEOVERS PANEL**

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August 2007

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## **PURPOSE OF THIS GUIDANCE NOTE**

1. The purpose of this note is to assist those who are approved as independent advisers by the Panel for the purposes of a report under any of rules 18, 21 or 22 of the Code or under a class exemption or specific exemption granted by the Panel from the Code. It should be considered an *aide memoire*. It is not intended to be a prescription by the Panel as to the matters an independent adviser must address in any report prepared for the purposes of the Code. It is expressed in general terms only and should not be regarded as comprehensive in any particular case. It should not be regarded as definitive and may be amended by the Panel from time to time.
2. This is the third edition of the guidance note and replaces the previous edition issued by the Panel in July 2003.
3. The Code requires the adviser to give an assessment of the “merits” of the particular offer (takeover), acquisition (share transfer or buyback), or allotment from the point of view of the recipient (in the case of a takeover offer) or of the person who is required to vote on the proposal (acquisition or allotment).
4. Philosophically the Code is concerned with the effect of changes in control between recognised points – 20% to 50%, 50% to 90%, and above 90%. The Code provides rights for shareholders at each stage. A primary focus of a Code report would often be the merits of incremental changes in voting control. These issues may have particular relevance in changes of control in the 20% to 50% zone which was recognised in formulating the Code as a critical area.
5. The Panel believes that an important role of the independent adviser is to advise shareholders of their rights under the Code, and suggests the adviser should be careful not to imply a proposal is meritorious, particularly in the 20% to 50% zone, simply because there are few negatives. It may well be that continuation of the status quo is the more desirable outcome unless there are good reasons why the shareholders should vote to approve a departure from it.

6. The Panel has for some time now been reviewing advisers' reports in draft form before they are finally distributed to shareholders. This process prompted the Panel to prepare the earlier versions of this guidance note. Recent developments in the market have prompted the Panel to issue this updated version.
7. The matter of original concern to the Panel was that advisers did not always inform shareholders of the protections and rights available to them under the Code or of the options available to the acquirer/bidder as a result of the Code. These issues have been largely addressed by advisers in their reports over the past two to three years. The issues which have prompted this revision of the guidance note include:
  - (a) A concern that independent advisers may be allowing their independence to be compromised in their use of subcontractors to undertake adviser assignments under the Code<sup>1</sup>;
  - (b) The need for some clarification in relation to the independence of advisers preparing reports in relation to successive takeovers occurring in close proximity to each other<sup>2</sup>;
  - (c) There has been an excessive concentration on the "fairness" of transactions, particularly takeovers, by advisers in their reports at the expense of a balanced consideration of the merits of a transaction<sup>3</sup>;
  - (d) The need for some clarification in the guidance note in relation to partial offers<sup>4</sup>.
8. In all cases the report must be an independent adviser's report and as such the directors of the target company, the offeror, the acquirer, the seller, the allottee or the allottor should not influence the findings or the choice of subcontractor, should one be needed.

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<sup>1</sup> See paragraph 12 onwards for discussion of this issue

<sup>2</sup> See paragraph 16 onwards for discussion of this issue

<sup>3</sup> See paragraph 29 onwards for discussion on this issue

<sup>4</sup> See paragraph 43 onwards for discussion of this issue

9. The Panel does not wish to prescribe the meaning of “merits” in relation to any particular transaction and nor does it wish to express a view of various valuation methodologies. The Panel makes the following suggestions in relation to some of the types of report that an adviser may be called on to complete.

## INTRODUCTORY COMMENTS ON THE APPOINTMENT OF ADVISERS

10. Independent advisers' reports play an important role in the scheme of the Code. The Panel takes its responsibilities for approving the appointment of independent advisers very seriously. Frequently, because of the timeframes stipulated in the Code, the approval of the appointment of the adviser by the Panel, and the preparation of the report itself, have to be undertaken in very compressed time periods. This has a number of implications:
  - (a) When making application to the Panel for approval as an independent adviser it is important that the application is complete in all respects. The Panel's policy for the approval of independent advisers is set out on its website at [www.takeovers.govt.nz](http://www.takeovers.govt.nz);
  - (b) It is important that the adviser has the skill base and resources available to it to complete all the work necessary to finalise its report to an appropriate standard in the limited time available;
  - (c) It is also important that the target or subject company itself has the information and personnel available to provide the independent adviser with the information necessary to complete its report, and also has the resources to be able to respond to the report itself.
11. The process of preparing and distributing independent advisers' reports within the timeframes stipulated in the Code (at least in relation to takeover offers) creates a tension between providing a report that is sufficiently comprehensive so that the target company shareholders are well-informed, while also providing the directors of the target company with enough time to give full consideration to the contents of the report. This underlines how important it is for the adviser, and the target company, to be adequately resourced to cope with their responsibilities and deal with any issues that are necessary.
12. In some cases the firm putting itself forward for approval as an independent adviser for a particular takeover or other Code transaction will not have the necessary

expertise to deal with all aspects of the adviser assignment. In such cases the primary adviser may need to engage the specialist services of a subcontractor to assist with aspects of its report.

13. The Panel considers the appointment of the proposed subcontractor at the same time that it is considering the application for approval from the primary adviser.
14. The Panel would expect the adviser to satisfy itself that the subcontractor it wishes to use has the necessary expertise and independence to undertake the assignment. Advisers must choose their own subcontractors and not allow the target company or any other party to choose a subcontractor for the assignment. In order to maintain the desired level of independence the Panel considers that the work of the subcontractor should be managed by the primary adviser and not, for example, by the target company or bidder.
15. Although the Panel approves the lead firm as the independent adviser for the purposes of the transaction, any such approval will also incorporate reference to any particular subcontractor that is to be used for the assignment.
16. Another issue key issue for the Panel is the independence of the proposed adviser
17. While some precluding interests are obvious, one which has arisen recently and which may not be so apparent concerns requests to approve the same adviser for successive, or follow-on, takeover offers involving the same parties.
18. As part of its overall consideration of an adviser's application one issue that the Panel will have to consider in such cases is the independence of the adviser if the same adviser were to be approved to prepare the follow-on rule 21 report. Factors the Panel is likely to consider could include:
  - (a) The proximity of the preparation of the two reports;
  - (b) Whether this is likely to be the last independent adviser's report to be provided to shareholders before compulsory acquisition is initiated;



- (c) Whether the business, circumstances or prospects of the target company have changed between the two reports;
- (d) The relationship between the value given in the adviser's first report and the offer prices under each offer;
- (e) Whether the shareholders are likely to benefit from having an independent adviser's report prepared by a different advisory firm from that which prepared the first report.

## **REPORTS REQUIRED IN RELATION TO TAKEOVER OFFERS**

19. The Code requires independent advisers' reports to be prepared at the request of the target company for the offerees in all takeover offers made under the Code. In every case a report requested by the independent directors of the target company under rule 21 of the Code is required to accompany the target company statement. In some cases, where full or partial offers have been made and there is more than one class of equity security (full offers) or more than one class of voting security (partial offers) an additional report under rule 22 of the Code is required (obtained at the request of the offeror) to certify the fairness and reasonableness of the consideration being offered as between different classes of equity security.
20. We make some observations about the requirements of these various reports in the next section of this paper. In all cases we recommend that the adviser ensures it has a thorough knowledge of how the relevant rules of the Code work.

### **Rule 22 Report - on the fairness between classes of a takeover offer**

21. Under rule 22 of the Code:
  - (1) An offeror must obtain –
    - (a) a report from an independent adviser if rule 8(3) or 8 (4) and 9(5) applies;
    - (b) a report or an amended report from an independent adviser if rule 44(3) applies;.
  - (2) In the report, the independent adviser must certify that, in the adviser's opinion, the offer complies with rule 8(3) or 8(4) or 9(3) as the case may be;.
  - (3) If an independent adviser's report is obtained, the offer is deemed to comply with rule 8(3) or 8(4) or 9(5) as the case may be..
22. Rule 8 of the Code states that where a person is making a full offer for all the voting securities of a company it must also make an offer for all the other classes of equity

securities of the company. That offer must be “fair and reasonable” as between the various classes of equity securities<sup>5</sup>. In order to ensure that the offer satisfies this requirement an independent adviser is required to certify that this is the case. Once the adviser has given this certificate then the offer is deemed to comply with the relevant rule. (Under rule 9 of the Code, dealing with partial offers, if there is more than one class of voting securities similar provisions apply.)

23. A series of technical amendments made to the Code with effect from 1 July 2007 allows for a bidder to revise the terms of its offer (without the prior approval of the target company’s directors) to include classes of securities of which it was unaware at the time it sent a takeover notice. In order to be able to rely on the procedure under the Code for this, a rule 22 report or amended rule 22 report (relating to the added classes of securities) has to accompany notification by the bidder to the target company, under rule 44(3), of the offer or offers for the added class(es) of securities.
24. A rule 22 report is probably the narrowest of all in scope. It is not a report on the merits of the offer, but only on the relativity between the offers being made for each class of equity securities. It is likely to be quite technical in nature, starting with the consideration being offered for the target company’s primary securities, and then assessing the relationship between that price and the value of the consideration being offered for other classes of equity security.
25. Issues that might arise in the report could include the conversion price that has to be paid to exercise any options or convertible notes in order for them to be converted into voting securities, and the period the options or conversion rights have to run.
26. Even if options are apparently worthless, because their exercise price exceeds current market value, the offeror under a full offer must still offer to purchase such securities. An assessment of the fairness of the price offered might include an assessment of the likelihood of the options having positive value in the future.

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<sup>5</sup> The offer must be fair and reasonable as between classes of voting securities, and as between voting and non-voting securities, where applicable.

## **Rule 21 report - on the merits of a takeover offer**

27. Rule 21 of the Code states:

The directors of a target company must obtain a report from an independent adviser on the merits of an offer

### ***Full offers***

28. At its simplest an independent adviser's report on a full takeover offer may be a valuation exercise comparing the consideration being offered by the offeror or bidder against various measures of the value of the target company. Questions the adviser could address, among others, include:

- (a) If a cash offer, is it worth more to the target company shareholder to stay in the company or to realise his or her investment for the price offered?
- (b) If the offer is a scrip offer, what is the value and the prospects of the company whose shares are being offered, against the value and the prospects of the target company?
- (c) Is it appropriate to include a premium for control? Does the offeror already have control of the target company?

29. One practice followed by most advisers since the Code came into force has been to make a comparison between the consideration being offered under a takeover and the valuation of the target company as the adviser assesses it. If the consideration offered exceeded the valuation then the offer was described as "fair". If the consideration offered was less than the valuation then the offer was described as "unfair" or "not fair".

30. The Panel recommends that advisers do not describe offers as "fair" or "unfair". A comparison of the offer price with the adviser's valuation should probably be made, but this is only one of a number of issues that the adviser may usefully discuss in its report on the merits of the offer.

31. One exception to this recommendation is where the primary purpose of the report is to provide guidance to shareholders who are certain to, or at least very likely to, have their shares taken under compulsory acquisition as the result of an offer. In such cases it may be appropriate for the adviser to express a view on the “fairness” of the offer price.
32. In preparing its report, particularly one involving a valuation, it is likely that an important issue for the adviser in making its valuation would be the reliance it should place on any forecast financial information available from the target company. This in turn could have a significant bearing on the quality of its final report. Issues that the adviser may need to consider could include, among others:
  - (a) The extent to which the adviser should rely on forecasts of future financial performance prepared by the target company;
  - (b) Whether the adviser should carry out its own “reasonableness tests” of prospective financial information provided by the target company before using that information in its report and any valuation it undertakes;
  - (c) Whether the adviser should prepare its own financial forecasts for the target company based on its own analysis, but using source data from the target company;
  - (d) The time period over which any forecast financial information does or should extend.
33. It is also important that the adviser have regard to any applicable professional standards. The Panel draws advisers’ attention to Advisory Engagement Standard No 2 *Independent Business Valuation Engagements* (“AES-2”) issued by the Institute of Chartered Accountants of New Zealand in 2001, and effective for all valuation engagements undertaken by members of the Institute from 1 April 2002. However, advisers should always be mindful that reports under the Code are not simply valuations, but are reports on the merits of an offer.

34. If there is any collateral transaction with one or more, but not all, shareholders of the target company in conjunction with the offer this is likely to raise the issue of the offer's compliance with rule 20 of the Code. Rule 20 states that an offer must be on the same terms and provide the same consideration for all securities belonging to the same class of equity securities under offer.
35. The Panel expects independent advisers, as part of their assessment of the merits of any particular offer, to satisfy themselves, and comment accordingly in their reports, on the reasonableness of the terms and conditions of any collateral transaction. If the adviser cannot be satisfied on the reasonableness of any collateral transaction this will raise the issue for the Panel that the offer may not comply with the Code.
36. The adviser may need to consider the position of the offerees if they opt not to accept the offer. These comments could cover, among others, matters such as:
  - (a) Whether, if the offer is conditional on the offer reaching 90%, this condition can be waived at the discretion of the bidder;
  - (b) The prospects of the consideration under the offer being increased if acceptances are coming in at a low level;
  - (c) The position of minority shareholders if the offer falls short of 90% acceptance, and/or the offeror waives any 90% condition that may have been part of the offer. For example:
    - (i) Could they be left as part of a small minority of shareholders, with an illiquid stock?
    - (ii) How may the remaining minority shareholders be affected by the offeror's plans for the target company once it has control, but they remain minority shareholders? Might these plans add value to the company in the near or longer term?

- (iii) How does the offeror propose to deal with conflicts of interest if it is an existing competitor of the target company and that company remains with minority shareholders?
  
- 37. The adviser may need to comment on the options available to the bidder under the Code if it reaches, or does not reach, the compulsory acquisition threshold. These comments could cover such matters, among others, as:
  - (a) The ability of the offeror to subsequently acquire sufficient shares through “creeping” under rule 7(e) to reach that threshold. If so, the adviser could note that “creeping” is generally not possible for approximately twelve months from the conclusion of the offer period;
  - (b) The rights of, and consequences for, the shareholder (as an outstanding security holder) under such a compulsory acquisition, having regard to Part 7 of the Code.
  
- 38. The situation of competing bids may also need to be addressed. The adviser’s comments could cover such matters, among others, as:
  - (a) The likelihood of competing bids emerging if there are no known competing bidders;
  - (b) A comparison of competing bids with the offer that is the subject of the report. What is the likelihood of one bid or the other being increased?
  - (c) Public statements that may have been made by the parties as to their intentions. (In this regard advisers should bear in mind the provisions of rule 64 of the Code relating to the prohibition on misleading or deceptive conduct in takeovers, once those provisions come into force.)
  - (d) The effects of the timing rules of the Code on the competition for control of the Code company. When should an offeree accept one offer or the other?

### *Partial offers*

39. With a partial bid the bidder must stipulate the percentage of the securities that it does not hold for which it is bidding. This is the “specified percentage”. Other than under the procedure described in the following paragraph, partial offers must have a minimum acceptance level of more than 50% of the voting rights in the target company and must obtain at least that percentage in order for the offer to be able to be successful. If acceptances fall short of the minimum acceptance percentage the offer will fail. If acceptances exceed the specified percentage they will be scaled back. In some cases shareholders may be successful in selling all their holdings into a partial offer but a more realistic assumption may be that current shareholders will be left with some shares in the target company.
40. If the offeror is seeking to acquire shares in the target company that would increase its control percentage to between 20% and 50% of the total voting rights, the offer must be approved by a majority of the shareholders of the target company not associated with the offeror that vote on the proposal<sup>6</sup>. This voting process takes place during the offer period.

### *Accepting or rejecting the offer*

41. In advising offerees as to the merits of accepting or rejecting the offer again the adviser could be undertaking a valuation exercise of the target company and, in the case of a scrip bid, of the offeror. The adviser may need to make a decision about how to value a partial interest in the target company. This in turn may depend on whether the bidder is seeking more than 50% of the voting securities or somewhere in the 20 – 50% range with shareholder approval.

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<sup>6</sup> The shareholders who are not eligible to vote are the offeror and its associates. If another shareholder is also making a takeover offer for the target at the same time it would be eligible to vote on the competing offer.



42. Some of the same considerations may apply as in a full offer, but there are likely to be additional complexities with a partial offer. Comments could cover matters, among others, such as:
- (a) The reasons for a partial bid as opposed to a full bid;
  - (b) Having regard to the percentage of voting rights that the bidder is seeking to control, the benefits that may accrue to the company and the shareholders who retain their shares if the specified level of control is achieved by the bidder;
  - (c) The prospects of a shareholder being able to sell all or most of his or her shares into the offer, having regard to the scaling rules of the Code and the likelihood of success of the offer. This discussion may have added significance if there are competing partial bids, with competing bidders starting from different voting control positions.
43. In commenting on the merits of a partial offer advisers may usefully reflect on whether control considerations outweigh pricing issues as far as the impact on target company shareholders is concerned.
44. The adviser could discuss the consequences for a shareholder if it were to choose to accept, or not to accept, the offer. The consequences of not accepting the offer might include:
- (a) If sufficient shareholders respond in the same way, the offer failing, or the bidder increasing its offer price or making a (later) full offer for all the equity securities in the company;
  - (b) Any premium for control that is being paid by the offeror being paid to only the accepting shareholders;
  - (c) In the event that the partial bid succeeds, the accepting and non-accepting shareholders being left as minority shareholders in a company controlled by a single shareholder, where those who have not accepted the offer would be left

with a greater level of shareholding interest than those who had accepted the offer.

45. The adviser may need to comment on any plans the bidder may have for the target company. These intentions should be disclosed in the offer document, at least insofar as the bidder proposes to make any material changes in respect of the business activities of the target company (clause 14, Schedule 1, of the Code). The adviser may comment on whether it considers the bidder will add value to the company over time. It may also be relevant to comment on how the bidder intends to deal with any conflicts of interest if it is already a competitor of the target company. If the bidder will not provide the adviser with any information on these questions the adviser may wish to comment accordingly.
46. Having regard to the Code, the adviser could also comment on future prospects for the remaining shareholders after a successful partial offer. These comments could cover matters, among others, such as:
  - (a) The controlling shareholder's "creep" rights under rule 7(e) of the Code (if it has control of over 50% of voting rights) (see above);
  - (b) The likelihood of future takeover offers under the Code from the controlling shareholder, or from other bidders;
  - (c) The likelihood of enhancement to the value of target company shares for the minority shareholders as a result of increased financial or managerial support for the company from the new majority shareholder, or of detriment to the value of those shares in the event of diminished liquidity and a reduced possibility of future takeover activity following a successful takeover.

*The right to vote for or against a partial offer*

47. If the bidder is seeking to acquire a voting percentage between 20 and 50% of the target company it can only do so with the approval of a majority of the shareholders of the target company not associated with the offeror, who vote on the proposal. This is a special right given to shareholders under the Code, and the Panel believes it is

important that shareholders are well advised of the merits of voting for or against a particular partial offer made in that range.

48. The adviser may need to comment on the reasons why a shareholder should be allowed to increase its control percentage in the 20 – 50% of control range without having to make an offer for more than 50% of the voting rights in the target company.
49. In addition, as with any offer, the offeree shareholder also has to decide whether or not to accept the offer. In making this decision a shareholder has to take into account that, regardless of his or her own voting position, the bidder could well get approval to make a bid in the 20 – 50% range. This is a complex situation, and one that we encourage advisers to explain well to target company shareholders.
50. The intended control outcome in the target company may be an important consideration in discussing the merits of the shareholders' choice whether to vote in favour of or against a partial offer that is seeking 50% or less control. Comments in the adviser's report could cover various matters, among others, such as:
  - (a) The effect of the offeror obtaining the sought after percentage, say, 35% of the voting rights, in the target. Does this holding give the bidder effective control of the company taking into account other shareholding blocks?
  - (b) The benefits that the bidder may bring to the company from an increased control percentage to justify the remaining non-associated shareholders voting to approve the percentage sought.
  - (c) The reasons why a shareholder might vote to approve the offeror obtaining a controlling stake without having to make an offer for all, or at least the majority, of the target company's voting shares.
  - (d) Whether there is a premium included in the price being offered by the bidder and, if so, what is that premium?
  - (e) The likely effects of the offer, if accepted, on the shareholder's own shareholding, given the Code's scaling rules?

**REPORTS REQUIRED FOR SHAREHOLDER MEETINGS UNDER THE CODE**

51. The Code is not only about takeover offers. The Code's provisions also apply where shareholders increase their control percentages above 20% by acquisitions from other shareholders approved by a meeting of shareholders under rule 7(c) of the Code, and by allotments approved by shareholders under rule 7(d) of the Code.
52. Under rules 7(c) and 7(d), and also under the terms of some analogous Panel exemptions, a report from an independent adviser on the merits of the acquisition or allotment must be provided to the shareholders entitled to vote on the relevant resolution.
53. In each case the shareholders (excluding the acquirer/allottee and its associates) are given the right by the Code to approve or reject proposals for another person to increase its control percentage of the code company. The Panel believes this right to approve should be exercised by the relevant shareholders with care and on the basis of good advice.
54. The Panel believes that it is an important part of the adviser's role to ensure that shareholders are properly advised of their rights under the Code. For example, shareholders should be made aware that it is not necessary to approve a proposal simply because there are few negatives. Shareholders can vote to allow the status quo to continue having taken into account reasons for and against that course of action.
55. We now comment specifically on some of the main reports prepared for shareholder meetings conducted under the Code.

### **Rule 18 report - on an acquisition under rule 7(c) or an analogous Panel exemption**

56. Under rule 18 of the Code:

The directors of the code company must obtain a report from an independent adviser on the merits of any proposed acquisition under rule 7(c) or allotment under rule 7(d) having regard to the interests of those persons who may vote to approve the acquisition or allotment.

57. A rule 7(c) acquisition is one where shareholder approval is being sought to an acquisition of a parcel of shares by one shareholder from another existing holder. The acquiring shareholder will be obtaining a shareholding of over 20%, or increasing an existing shareholding to somewhere between 20% and 50%<sup>7</sup>, from another party or parties. The acquisition may be of a Code company's shares, or it may be of the shares of another company, generally an upstream company that controls voting rights in the Code company.

58. The independent adviser is not advising the parties to the transaction, but instead those who have the right to vote to approve or disapprove the acquisition. As such, valuation may or may not be the key issue. The consideration for the transaction may well be an issue if the acquirer is obtaining a controlling parcel of shares without making an offer to remaining shareholders. The price being paid could impact on the market value of the holdings of existing shareholders if the parcel is large enough. The adviser may address the question of whether the value of the voting shareholders' shares is likely to be affected by the level of consideration.

59. The shareholders of the Code company, other than the buyer(s) and the seller(s), must approve any changes in holdings of shares that increase the acquirer's holding<sup>8</sup> above 20%<sup>9</sup> unless the acquiring shareholder makes either a full or a partial bid for the target company in which all shareholders would have the right to participate.

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<sup>7</sup> The provisions can be used to obtain a higher voting percentage than 50%, but are generally designed for movement in the "no-fly" zone of 20 – 50%.

<sup>8</sup> The acquirer's holdings are aggregated with those of all its associates when determining whether the 20% threshold is going to be exceeded.

<sup>9</sup> If the acquirer already holds or controls more than 50% of the voting rights it may be able to "creep" by 5% under rule 7(e) without needing shareholder approval.

60. Factors covered in a report might include, among others:
- (a) The prospects of the acquirer making a full or partial bid for the company if the shareholders vote against the acquisition;
  - (b) The benefits the acquiring shareholder is expected to bring to the company;
  - (c) The affect on control of the company. What would the shareholding blocks be after the acquisition? Who would have effective control?
  - (d) Whether the acquiring shareholder is obtaining control of the company without paying a control premium, or is it paying a control premium from which only a few shareholders are going to benefit?
  - (e) Is the target company in such a dire financial condition that a new controlling shareholder is essential to the company's survival?
61. The Panel would prefer not to see advisers refer to transactions as being "fair" or "not fair" to shareholders. See page 7 above for the Panel's views on discussions about the "fairness" of transactions.

**Rule 18 report - on an allotment under rule 7(d) of the Code or an analogous Panel exemption**

62. A rule 7(d) allotment is one where the allotting company is going to allot sufficient shares to the allottee that its control of voting rights in the allotting Code company following the allotment<sup>10</sup> will be greater than 20%.
63. The independent adviser is required to report on the merits of the allotment from the point of view of those entitled to vote on it. Those entitled to vote are the Code company's shareholders, excluding the allottee and its associates. As such they are likely to be minority shareholders whose interest in the Code company is being diluted. Depending on the nature of the allotment these shareholders may also have the right to participate in the offer being made, for example if there is a pro-rata offer being made to all shareholders but underwritten by a major shareholder (and approval under rule 7(d) is being sought in respect of that major shareholder).
64. If the allotment being made is one where all shareholders have the right to participate then the merits of the allotment could include, among others:
- (a) How the allotment price relates to a number of different reference points, including, but not limited to:
    - (i) The recent market values of the allotting company's shares;
    - (ii) A valuation of the whole company;
    - (iii) Discounts employed in other allotments or placements in the market.
  - (b) The likely value of any rights to acquire shares that the allottee shareholder may receive, whether they are tradeable, and the impact on a shareholder's existing holding if the rights are not exercised (and an underwriting shareholder increases its control)<sup>11</sup>;

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<sup>10</sup> As with an acquisition, the allottee's prospective holding will be aggregated with the holdings of its associates for the purpose of determining if the Code applies to the allotment.

<sup>11</sup> Note that as a matter of policy, where the Panel grants an exemption from rules 7(d) and 16 to allow an underwriting shareholder to increase its control percentage through taking up a shortfall in a rights issue it will

- (c) The purpose or purposes to which the proceeds of the allotment are intended to be put;
  - (d) If there is a major shareholder underwriter of the issue:
    - (i) the process the target company followed before deciding to enter into an underwriting agreement with the major shareholder;
    - (ii) the basis on which the underwriting terms were agreed with the underwriting shareholder;
    - (iii) the likelihood of the underwriter being called upon;
    - (iv) the ongoing effect on the control and direction of the company if there is a significant shortfall in subscriptions to the issue, with the unsubscribed shares to be taken up by the underwriter.
  - (e) The effect on control of the company if the non-associated shareholders (i.e. those for whom the report is being written and who will have the opportunity to vote on the allotment) participate, or do not participate, in the offer;
  - (f) The consequences for the non-associated shareholders and the allotting company if the shareholders vote against the allotment, having regard to the provisions of the Code and the existing structure of voting control within the company.
65. Again, the Panel recommends that the allotment not be described in terms of its “fairness” or “unfairness”.
66. If the allotment is one in which the non-associated shareholders will not have the right to participate, but is one where the principal allottee is intended to obtain a significant stake, or increase an existing stake, in the allotting company, the only issue for the non-associated shareholders to decide is whether to vote for or against the proposed

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be a condition of the exemption that the underwriting shareholder is not able to purchase rights in the market, whether it intends to exercise those rights or not.



allotment. The independent adviser's role is to advise the voting shareholders on the merits of voting for or against the proposed allotment. Factors that the adviser could consider in such a report may include, among others:

- (a) The purposes to which the proceeds of the allotment (if cash) will be put;
- (b) If the allottee is contributing business assets rather than cash, how these will change the existing business of the company. Comment on the value of the assets may be appropriate. Are there other benefits of a strategic or marketing nature?
- (c) The effect on the control position of the allotting company if the allotment proceeds;
- (d) A comparison of the allotment price with recent market prices for the shares of the allotter and the value of the company, and its likely effect on the future market value of the non-associated shareholders' shareholdings (diluting effect);
- (e) The consequences for the company and the non-associated shareholders if the allotment is not approved. Could the company fail? Could the company be foregoing a valuable opportunity to obtain new capital that may not arise again?

### **Report for the purposes of a buyback under clause 4 of class exemptions**

67. Clause 4(2)(d) of the Takeovers Code (Class Exemptions) Notice (No 2) 2001, relating to exemptions for buybacks approved by shareholders, provides, as a condition of the exemption:

Rules 18 and 19 of the Code are complied with in relation to the proposed acquisition<sup>12</sup> (as if the references in those rules to acquisition under rule 7(c) of the Code and notice of meeting referred to in rule 15 of the Code were references to the acquisition and the notice, respectively.)

68. Existing shareholders may increase their control percentage through a buyback undertaken by a Code company in which they do not participate (“the increasing shareholders”), either because the offer is not made to them (selective buy-back) or they opt not to accept the offer.
69. If shareholders not associated with the increasing shareholders approve the buyback for the purposes of the Code, under clause 4 of the class exemptions the increasing shareholders may retain their resultant increased control percentages.
70. If the non-associated shareholders do not approve the buyback for the purposes of the Code then the increasing shareholders must, within six months of increasing their control percentage, sell down their shareholdings so that their control percentages revert to pre-buyback levels (see clause 5 of the class exemptions). In the meantime those increasing shareholders cannot exercise the voting rights attached to the shares that represent the increased control percentage.
71. The way the class exemptions are structured, the meeting of shareholders at which the buyback is approved for Code purposes will precede the making of the buyback offer to shareholders (see the Panel’s determination in relation to TrustPower Limited dated 16 April 2003 (available on the Panel’s website at [www.takeovers.govt.nz](http://www.takeovers.govt.nz) under “Decisions”)).

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<sup>12</sup> In the case of a buyback the “acquisition” referred to is the company’s acquisition of its own shares

72. For the purposes of the class exemption the adviser is required to provide the non-associated shareholders with a report on the merits of the “acquisition”, which in this context is the buyback by the company of its own shares, from the point of view of those shareholders voting on the acquisition. However, since this is a report for the purposes of the Code a significant issue to be discussed is the change in control percentage that is expected to occur for the increasing shareholders.
73. A buyback is approved by the directors of the company under the Companies Act 1993 and cannot proceed unless the buyback is considered by the directors to be in the best interests of the company and its shareholders (Companies Act s63(1)(b)) and fair and reasonable to the company and its shareholders (Companies Act s63(1)(c)).
74. A buyback may take several forms, including:
- (a) an offer in which all shareholders have the potential to participate and that is achieved through on-market transactions at then-current market prices over a period of time;
  - (b) a discreet offer at a fixed price made to all shareholders; or
  - (c) a discreet offer at a fixed price made to a selected group of shareholders.
75. It may be helpful for the adviser to distinguish between:
- (a) the buyback itself, which under the Companies Act 1993 and the Exchange’s Listing Rules the shareholders may not have to approve; and
  - (b) the potential for an increase in the control percentage of one or more major shareholders if the acquisition (buyback) proceeds, necessitating approval of the buyback by the non-associated shareholders for the purposes of the Code.
76. If the buyback is one for a fixed price over a short period of time, with the offer made to all shareholders, or a selected group of shareholders, off-market, the adviser may need to consider, among other matters:

- (a) The merits of the buyback transaction itself from the point of view of the shareholder as a person who will have to consider whether or not to accept the offer; and
  - (b) The merits of the buyback transaction as concerns its impact on the control of the company from the point of view of the shareholder who has to decide whether or not to approve the buyback and thus allow the increasing shareholders to increase their control percentages in the target company.
77. From the perspective of the shareholder as a recipient of the offer the issues could include, among others:
- (a) A comparison between the price being offered for each share compared with the value of each share pre-buyback offer. The likely impact on the value of shares after the buyback. Whether net tangible asset backing is a useful comparison to use. Will the NTA of the shares remaining in the company after the buyback be higher or lower than their value before the buyback?
  - (b) The effect of the buyback on the liquidity of the shares. Whether the buyback provides an opportunity for the shareholders to cash-up their shareholding without impacting the market value of the shares, but possibly at the cost of reduced liquidity after the buyback (when the pool of available shares is likely to be also reduced).
  - (c) The company's capacity to fund the buyback. Is this a way of utilising otherwise surplus cash? Will the company have to borrow to fund the buyback? If so, what impact might this have on debt/equity ratios?
78. From the point of view of the shareholder as someone who has the opportunity to vote to approve or reject the Takeovers Code element of the buyback, that is to say the change in control percentage of the increasing shareholders, the issues could include, among others:

- (a) Whether this is a means by which the increasing shareholders can obtain increased control percentages without having to pay a premium for the level of control to be achieved;
  - (b) The likely outcome if the shareholders vote against the proposal. For example, will the buyback still go ahead, but without the increasing shareholders being able to retain and vote their increased control percentages? What are the prospects of the increasing shareholders making a Code offer to all shareholders?
79. If the buyback is one where shareholder consent is not required under the Companies Act or the Listing Rules, and where acquisitions can take place at market prices at any time over a future period, the issues may be slightly different. The buyback transactions will occur at prevailing market prices when the directors consider it is in the best interests of the shareholders and the company for the company to buy its own shares. There is thus no fixed reference point against which to assess value. In this case comments could cover matters, among others, such as:
- (a) A comparison between current market prices and the assessed value or net tangible asset value, if relevant. What would be the effects on the assessed value or the NTA of remaining shares if the buyback proceeds at current market value?
  - (b) The benefits for shareholders if the buyback proceeds;
  - (c) The likelihood of the buyback proceeding anyway if the shareholders vote against the buyback for the purposes of the Code<sup>13</sup>;
  - (d) The prospects of all shareholders being able to participate in the buyback. Not all shareholders are likely to want to take the opportunity to sell into the buyback. This will depend on which shareholders wish to sell when the company is offering to buy;

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<sup>13</sup> If this occurs the increasing shareholders would have to reduce their increased control percentage back to pre-buyback levels within six months, and could not exercise those increased voting rights in the meantime.

- (e) The implications for control of the company if the buyback is approved;
  - (f) The options available to the increasing shareholders if the shareholders vote against the buyback. Is the shareholder able to “creep” under rule 7(e)? Might the shareholder make a full or partial takeover offer for the company?
80. As previously, the Panel prefers that the buyback offer not be described in terms of its “fairness” or “unfairness” to the voting shareholders.
81. In all buybacks the fundamental reason for the meeting under clause 4 of the class exemptions is for the non-associated shareholders to effectively approve (by their approval of the buyback) the increasing shareholders obtaining an increased level of control of the company. A significant issue for the report is the identification of the reasons that justify the waiving of the normal Code restrictions on increases in voting control.

## CONCLUSION

82. The Panel considers that the role of the independent adviser is critical to the effectiveness of the Code in regulating the market for the control of Code companies.
83. The independent adviser helps ensure that there are well-informed shareholders whenever a takeover offer is made or another transaction is occurring that requires shareholder approval under the Code. For this reason the Panel takes a close interest in the skills as well as the independence of any company or individual proposed for appointment as an independent adviser.
84. Advisers need to fully appreciate the philosophy of the Code, the rights it creates for shareholders, and the importance of their role in the process. Reports must be of a high quality and give balanced advice.
85. The Panel intends to continue with its current policy of reviewing reports prepared by independent advisers for the purposes of the Code and will provide comments to the advisers on draft reports where it considers this is necessary.
86. The independent directors of the target or allotting company also have important responsibilities in the process. The Panel believes, on the basis of some of the reports it has seen, that not all independent company directors have appreciated the extent of those responsibilities.
87. The directors need to ensure that the appointed adviser is given all the information necessary to provide a comprehensive report. They should, in the course of reviewing the independent adviser's draft report, satisfy themselves that it is sufficiently comprehensive, is factually accurate, and covers all the relevant issues.
88. This paper replaces the guidance note issued by the Panel in July 2003.