

Submission on upstream takeovers

1. Introduction

- 1.1 This submission is prepared by Bell Gully in response to the consultation paper titled 'Upstream Takeovers' released by the Takeovers Panel (the **Panel**) in April 2009.
- 1.2 The views expressed in these submissions are those of a number of members of our firm with relevant experience. They do not necessarily represent the views of our clients.

2. General observations

- 2.1 Bell Gully supports the Panel's proposal to provide certainty in relation to upstream takeovers that result in changes in control of downstream Code companies.
- 2.2 We set out our responses to the specific questions raised in the discussion document below.

3. Policy objectives

A. Do you agree that there is a problem? If you do, do you consider that the discussion document explains the problem adequately? If not please explain your views:

- 3.1 The discussion document states that upstream acquisitions are relatively common and account for roughly 10 per cent of all exemptions granted by the Panel. However, a brief survey of listed companies indicates there are relatively few companies with significant listed shareholders.
- 3.2 Although not all Code companies are listed, this does tend to indicate that upstream acquisitions involving a listed parent are unlikely to arise that frequently. The fact that the discussion document only cites five examples over the last nine years of the Panel granting exemptions for upstream takeovers tends to support this conclusion.
- 3.3 This does not mean that there is no problem and in our view reform is desirable in this area in order to achieve certainty for Code companies and their shareholders. A key issue in terms of providing certainty to market participants, which is only considered in passing in the discussion document, is the method for valuing the offer that must be made to the downstream Code company's shareholders if the upstream transaction is deemed not to fall within the relevant exemption. This is a key consideration in terms of achieving the objectives of the Code, and, in our view, should be considered in greater detail as part of any reform of this area.

B. Are the stated policy objectives appropriate for assessing the options included in this discussion document?

- 3.4 The objectives of the Code listed in section 20 of the Takeovers Act are, in brief, to promote: efficient allocation of resources; competition for the control of Code companies; fairness for shareholders; international competitiveness of capital markets; and a proper relation between the costs / benefits of the Code.
- 3.5 We agree that these objectives are appropriate for assessing the options for reform presented in the discussion paper.

C. Are there other objectives which you think should be included for the assessment of the options discussed, or should some of the objectives used in this discussion document be excluded? Why?

- 3.6 For the purposes of assessing the options for reform, we believe that it is appropriate to include compliance with the principles of international comity as an objective.
- 3.7 We believe that principles of transparency and certainty should also be included as an objective. When evaluating the proposed options, a key consideration should be whether the option is likely to operate in a transparent and consistent fashion. The regime must be sufficiently transparent for potential acquirers and their advisers to be able to predict its application to a proposed upstream acquisition, including, if applicable, the method of valuation of any follow on offer. If discretion is to be conferred, it should be accompanied by guidance sufficient to provide the level of transparency and certainty required by potential acquirers.

D. Are some objectives more important than others? Why?

- 3.8 We believe it is appropriate to attribute greater significance to some objectives over others in particular situations. The objective of encouraging competition for the control of specified companies is in our view of less importance than the objective of international comity in the context of upstream takeovers.

4. Options

- 4.1 In the discussion document, the Panel identified several options for reform, which we set out again for ease of reference:
- **Option 1:** maintain the status quo which requires every upstream acquirer either to make a full takeover offer for the downstream Code company, obtain approval from the shareholders of the Code company, or obtain an exemption from the Panel (which the Panel will consider on a case by case basis).
 - **Option 2(a):** adopt the UK approach which contains a class exemption from the Code for an upstream acquisition in circumstances where a person acquires control of a downstream Code company unless either:
 - control of the downstream company is a main purpose of the upstream acquisition (the **Purpose Test**); or
 - the shareholding in the downstream Code company is significant in relation to the upstream company (relative values of 50 per cent or more will normally be regarded as significant) (the **Value Test**).
 - **Option 2(b):** identical to Option 2(a) except that the threshold for what is a significant value in the Value Test is lowered to 25 per cent or more.
 - **Option 2(c):** identical to Option 2(a) except that the class exemption will only apply to upstream transactions on exchanges that the Panel considers offer investor protection comparable to New Zealand.
 - **Option 3:** provides a class exemption from the Code for an acquisition that results from an upstream acquisition of an entity listed on exchanges that the Panel considers offer investor protection comparable to New Zealand.
 - **Option 4:** identical to Option 3, except that the Panel is left with discretion to declare “unacceptable circumstances” (mirrors Australian position).

E. Are there any other options you believe the Panel should consider? What are they and why should they be considered?

- 4.2 We believe that the options proposed by the Panel are the appropriate options and do not believe that it would be useful to consider any other options.

F. Do you agree with the Panel's assessment of the impact of the options? If not, what would your assessment be and why?

Options 1 and 3

- 4.3 We agree with the Panel's assessment that Option 1 (retaining the status quo and leaving the Panel to consider exemptions on a case by case basis) results in inefficiency, potential non-compliance with international comity and a lack of transparency.
- 4.4 We also agree with the Panel's assessment that Option 3 (providing a complete exemption for upstream acquisitions made on an approved exchange) could result in situations where shareholders were not treated fairly.

Options 2(a) – 2(c)

- 4.5 We generally agree with the Panel's assessment of Option 2(a) (the UK position).
- 4.6 The Panel's assessment of Option 2(a) is that the only relevant considerations are the Purpose Test and the 50 per cent Value Test, while the wording of the UK provision appears to indicate that some residual discretion as to whether or not to require an offer is left to the Panel. Note 8 to Rule 9.1 of the City Code on Takeovers and Mergers states that "the Panel *will not normally* require an offer to be made under this Rule in these circumstances" unless either of the Purpose Test or the 50 per cent Value Test applies. This appears to leave the UK Panel with some further discretion as to whether to require a follow on offer.
- 4.7 In addition, the Purpose Test involves a subjective element, and it would be useful for the Panel to provide guidance as to how it intends to determine the purpose of an upstream takeover.
- 4.8 Subject to the comments made above in relation to Option 2(a), we generally agree with the Panel's assessment of Option 2(b) (which is identical to Option 2(a) but lowers the threshold for the Value Test to 25 per cent) and Option 2(c) (which is identical to Option 2(a) but requires that the upstream target is listed on exchanges that the Panel considers offer investor protection comparable to New Zealand).

Option 4

- 4.9 We believe that the Panel's assessment of Option 4 (the Australian position) does not address some significant issues. The most significant of these is that the adoption of section 657A of the Corporations Act 2001 will not necessarily lead to the same results in New Zealand as in Australia due to the much larger body of market precedent in Australia. It is likely that upstream takeovers will continue to be fairly rare in New Zealand due to the low number of Code companies with significant listed shareholders and the small size of the New Zealand market.
- 4.10 In Australia, the "unacceptable circumstances" powers of the Panel are of much more general application and are a significant feature of Australia takeover law and practice. In our view it is not appropriate to import that feature into New Zealand takeover law, especially in an isolated area such as upstream takeovers.

- 4.11 Powers to declare unacceptable circumstances are, in our view, not consistent with the general scheme of the Code which sets out detailed (and certain) rules rather than giving the Panel broad discretionary powers (other than to grant exemptions).

G. What option do you prefer and why?

- 4.12 The options we prefer are those that create a certain set of rules which can be applied to determine whether an upstream takeover does or does not trigger a need to comply with the Code in relation to the downstream company.
- 4.13 Those certain rules would, as with other provisions of the Code, be complemented by the Panel's general power to grant exemptions in appropriate circumstances for transactions that did not or could not meet the requirements of the Code.
- 4.14 In our view, either of Option 2(a) (the UK position) or Option 2(c) would be suitable for adoption in New Zealand as both of these approaches adopt the Purpose Test and the 50 per cent Value Test, with the only difference between them being that Option 2(c) has the overlay of the upstream target needing to be listed on a reputable exchange.

5. Further information

- 5.1 Thank you for the opportunity to make this submission. If you require any further information in relation to this submission please contact any of the following members of our Corporate/Commercial Department:

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Yours faithfully
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