Guidance Note

CONTROL AND ASSOCIATION

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TAKEOVERS PANEL
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Contents

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This Guidance Note provides information on the concepts of control and association (key anti-avoidance provisions in the Code). In addition to a discussion of the general topics, there is also:

- information on how these concepts relate to lock up agreements and shareholders agreements;
- examples of the application of the rules in "live" examples; and
- examples of exemptions involving rule 6(2) of the Code which have been declined as they did not infringe the deeming rule in rule 6(2).

1 Introduction

1.1 The Takeovers Code is concerned with transactions that cause a person to become the holder or controller of an increased percentage of voting rights in a Code company.

1.2 The fundamental rule contained in rule 6 (1) of the Code provides that:

> *Except as provided in rule 7, a person who holds or controls—*
>
> *(a) no voting rights, or less than 20% of the voting rights, in a code company may not become the holder or controller of an increased percentage of the voting rights in the code company unless, after that event, that person and that person's associates hold or control in total not more than 20% of the voting rights in the code company:*
>
> *(b) 20% or more of the voting rights in a code company may not become the holder or controller of an increased percentage of the voting rights in the code company.*

1.3 The Code contains two key anti-avoidance mechanisms to prevent its application being circumvented by transaction structuring techniques: the first is the concept of "control" of voting rights; the second is the concept of "association".

2 Control

2.1 The Code would be ineffective if it regulated only voting rights held by a particular company or individual. If the fundamental rule were triggered solely by changes in a person's holding, it could be easily avoided by property-based arrangements (e.g., by using nominees) or contractual ones (e.g., by voting agreements). Accordingly, the control limb of rule 6(1) ensures that changes in control of a Code company cannot be hidden behind ownership or contractual arrangements.

3 Association

3.1 The association concept requires that when two or more associated parties acquire ownership or control of voting rights in a Code company, the voting rights held or controlled by each of them must be added together to determine whether rule 6(1) is triggered.

3.2 Rule 4(1) of the Code defines "associate" as follows:

> *For the purposes of this 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 Panel Guidance

4.1 The Panel issued a detailed explanation of these anti-avoidance mechanisms in *CodeWord 7* (September 2002). Also, Schedule A to this Guidance Note outlines two applications for exemptions that are illustrative of the Panel's interpretation of the anti-avoidance rules in rule 6(2) of the Code.

5 Lock up agreements

5.1 Parties to lock-up agreements need to take care to ensure that they adhere to the fundamental rule of the Code (i.e., no person, together with their associates, increases their shareholding over 20% other than in accordance with the Code or an exemption). A lock-up agreement is a legal commitment by a shareholder in a Code company to accept a takeover offer.

5.2 Parties to a lock-up agreement may be associates of each other for the purposes of the Code, but the terms and nature of those agreements and the surrounding circumstances need to be considered on a case by case basis. The Panel considers that an associate relationship may not exist, merely by virtue of a lock-up agreement, if:

(a) the agreement is a commercial arm's length commitment (i.e., a straightforward agreement to make and accept a takeover offer and the parties are not acting jointly or in concert, but rather on opposite sides of the contract);

(b) the agreement does not go beyond making and accepting a takeover offer, and does not include ongoing covenants;

(c) there is no other ongoing relationship of the parties (i.e., the relationship ends when the shares are transferred in accordance with the takeover offer);

(d) the agreement expressly precludes control of voting rights passing to the offeror prior to the takeover offer becoming unconditional; and

(e) the agreement is short-term, lasting no longer than the settlement or lapsing of the takeover offer.

5.3 The above list is not an exhaustive list of the terms that may be included in lock-up agreements without creating an associate relationship under the circumstances. Generally, in a lock-up agreement the seller will wish to approve the terms on which the offer is made and any variations to the terms. The Panel accepts that within reason it is a necessary incident of a lock-up agreement, but it will be a question of degree in each case as to whether the extent of the approval rights is such as to make the lock-up parties associates.

5.4 The Panel accepts that the seller will wish to have certainty as to the essential terms on which the offer will be made, such as price, timetabling and material conditions. Provisions which seek to do no more than this are unlikely of themselves to make the parties associates under the circumstances; and nor are terms which secure a proportionate commercial benefit for all shareholders, such as making acceptance of the offer contingent on the target company paying a dividend or making a taxable bonus issue.

5.5 However, the more control a seller seeks to exert, particularly with terms or other arrangements which seek to exert influence over the behaviour of an offeror once an offer has been made, the more likely it is that the Panel may conclude that in the circumstances the parties are associates.

5.6 As a broad proposition, however, many lock-up agreements will not result in an assumed association between the parties.

5.7 For examples of both lock-up agreements that would likely not, and lock-up agreements that likely would, result in the lock-up parties being associates merely by virtue of the lock-up agreements, see CodeWord 39.

6 What does this mean for parties that are not associates?

6.1 If the lock-up parties are not associates merely by virtue of entering into a lock-up agreement, prospective takeover offerors could acquire up to 20% of the voting rights after entering into the lock-up agreement and in advance of actually making the takeover offer. The non-associated lock-up parties' voting rights would not need to be considered at this point in terms of the fundamental rule.

6.2 Rule 36 of the Code provides that, during the offer period, the offeror must not acquire any equity securities in the target company other than under the offer unless, among other things, the acquisition will not result in the offeror and the offeror's associates holding or controlling in total more than 20% of the voting rights in the target company (excluding acceptances under the offer), unless the offer has become unconditional. If the lock-up parties are not associates then any acquisitions made by the offeror under rule 36 do not need to take into account the percentage of the locked-in parties' voting rights for the purposes of the 20% threshold.

6.3 When determining compulsory acquisition consideration when an offeror has become a dominant owner by reason of acceptances of an offer, rule 56 provides that if more than 50% of the equity securities under offer are accepted into the offer then the consideration price will be the offer price (and there is no provision for objecting to the consideration). However, the equity securities held or controlled by the offeror and its associates are excluded from this calculation, as are acquisitions made under rule 36. The remaining acceptances are termed the 'free float'.

6.4 If the lock-up parties are not associates of the offeror, then their voting rights are included for the purposes of determining whether more than 50% of the free-float is accepted into the offer.

6.5 If 50% or less of the free-float is accepted into the offer (and the offeror becomes the dominant owner) then rule 57 provides that shareholders may object to the compulsory acquisition consideration.

6.6 These are just some examples of the Code provisions that relate to association and affect lock-up parties.

7 Shareholders' agreements

7.1 The Panel's view on shareholders' agreements is that the parties to those agreements may be associates for the purposes of the Code. Whether or not those parties are in fact associates will depend on the nature of the shareholders' agreement and the surrounding circumstances.

7.2 The Panel will consider the following matters in order to help determine whether or not an associate relationship may exist between the parties to a shareholders' agreement:

(a) an agreement that merely contains terms relating to pre-emptive or drag/tag along rights and obligations is unlikely on its own to give rise to an associate relationship;

(b) an agreement that contains terms relating to voting requirements or that gives certain shareholders specific rights, such as for appointment as directors, may give rise to an associate relationship;

(c) whether the agreement applies to all or a select group of shareholders may also be relevant (with agreements for select groups or individuals increasing the likelihood of their being associates of each other); and

(d) collateral arrangements or ongoing relationships outside of the shareholders' agreement should be considered together with the shareholders' agreement and together these may give rise to an associate relationship.

7.3 The terms of shareholders' agreements can vary significantly and may relate to a period of time when the company had a small number of shareholders. It is difficult to identify specific principles to determine whether the

parties to a shareholders' agreement may be associates. The above guidance is therefore very general and the Panel considers questions of association for these types of agreements on a case-by-case basis.

7.4 The Panel has in the past granted an exemption to allow the parties to unwind an agreement in order to "dis-associate" themselves.[1] If the parties to an agreement are likely to be associates of one another merely by virtue of their being party to a shareholders' agreement, an exemption may be granted to aid transition to full Code-compliance.

8 Application of the Anti-avoidance rules in "live" examples

8.1 This section sets out examples of cases which the Panel has examined in relation to the application of the anti-avoidance rules.

Kerifresh Limited – Control and Association

8.2 Kerifresh Limited (**Kerifresh**) was a Northland-based citrus producer and exporter founded by Alan Thompson and Peter Hendl. At the time the relevant matters were considered, Kerifresh was an unlisted Code company.[2]

The warehousing agreement

8.3 In early 2002 Peter Hendl decided to sell his 17.84% shareholding in Kerifresh. Hamish McHardy and his son Jonathan McHardy wished to take up Hendl's shares. However, Hamish McHardy required, as a condition of his investment in Kerifresh, managing director Alan Thompson (who already had 18.49%) to take up 361,000 of Peter Hendl's shares (which represented 5.08%).

8.4 Alan Thompson did not want it known that he was a purchaser of Hendl's shares. He and Hamish McHardy therefore entered into an agreement (characterised by the Panel as a "warehousing agreement") under which Hamish McHardy, using Alan Thompson's money, would buy the 361,000 shares and hold them for Alan Thompson's economic benefit. No provision was made as to who controlled the voting rights attaching to those shares.

2002 - Hamish McHardy and Jonathan McHardy's acquisitions

8.5 As a result of the acquisition of Hendl's shares, Hamish McHardy increased his shareholding to 9.57%, of which 5.08% was subject to the warehousing agreement. Jonathan McHardy, through the Murrayfield Trust (his family trust, of which Hamish was also a trustee), increased the percentage of shares that he controlled in Kerifresh to 8.69%.

McHardys considered associates – Rule 4(1)(d)

8.6 The Panel found the McHardys to be associates under rule 4(1)(d) of the Takeovers Code on the basis of their personal relationship as father and son, their business relationship as co-investors in Kerifresh and other ventures, and their ownership relationship as co-trustees of the Murrayfield Trust.

Hamish McHardy and Alan Thompson considered associates – Rule 4(1)(d)

8.7 The Panel considered that Hamish McHardy and Alan Thompson were associates also under rule 4(1)(d) as a consequence of the business and ownership relationships stemming from the warehousing agreement.

8.8 Hamish McHardy's acquisition therefore breached rule 6 because his increase in the percentage of Kerifresh voting rights that he held to 9.57%, when added to the percentage of voting rights held or controlled by his associates

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[1] Takeovers Code (Ormiston Surgical & Endoscopy Limited) Exemption Notice 2011

[2] See *CodeWord 23* for a fuller description of the Kerifresh facts and findings (including explanations regarding the changes to the shareholder percentages referred to in this summary of the case).

Jonathan McHardy (8.69%) and Alan Thompson (18.49%), exceeded 20%. The same was true of certain subsequent acquisitions Hamish McHardy made through an investment vehicle.

Jonathan McHardy and Alan Thompson considered associates – Rule 4(1)(e)

8.9 The Panel also considered that the nature of the relationships between Jonathan McHardy, Hamish McHardy and Alan Thompson were such that, under the circumstances of Jonathan McHardy's acquisitions, Jonathan McHardy and Alan Thompson were associates under rule 4(1)(e).

8.10 Whilst there was no evidence that Jonathan McHardy was directly involved in the negotiation of, or participated in, the warehousing agreement, the Panel considered that Jonathan McHardy and Alan Thompson were associates under rule 4(1)(e) because Jonathan McHardy was aware at least in general terms of that arrangement, which was a material factor in the Murrayfield Trust's decision to buy shares from Hendl.

8.11 This is one of the few occasions on which the Panel has found persons to be associates under rule 4(1)(e).

8.12 Jonathan McHardy's acquisition breached rule 6 because the increase in the percentage of Kerifresh voting rights that he held, to 8.69%, when added to the percentage of voting rights held or controlled by his associates Hamish McHardy (9.79%) and Alan Thompson (18.49%), exceeded 20%.

2004 – GMS acquisitions and warehousing agreement unwind

8.13 In early 2004, Hamish McHardy wanted to increase his Kerifresh shareholding. However, he had become aware that the Code applied to Kerifresh and that he and his son were probably associates. With an aggregate shareholding at that time of about just under 20%, he would be prohibited from acquiring much more of Kerifresh. He therefore sought to unwind the warehousing agreement.

8.14 For various reasons, the way this unwind was structured was that a company called GMS Fulfilment NZ Limited (**GMS**) would buy Kerifresh shares with Hamish McHardy's money and hold those shares for Alan Thompson's economic benefit pending transfer to Alan Thompson. The shares acquired by GMS would replace the shares which were subject to the warehousing agreement, which could then be released back to Hamish McHardy. This would unwind the warehousing agreement while simultaneously increasing Hamish McHardy's economic interest in Kerifresh. Between July 2004 and June 2005 GMS acquired 245,000 shares, representing 3.45% of Kerifresh, pursuant to this strategy. Accordingly, only 116,000 of the original 361,000 shares remained subject to the warehousing agreement.

GMS acquisition causes Alan Thompson to be in breach of Code

8.15 The Panel found that Alan Thompson controlled the shares acquired by GMS. The Panel considered that GMS and Alan Thompson, and GMS and Hamish McHardy, were associates under rule 4(1)(d) of the Code, in view of the business relationships they had with each other, directed at unwinding the warehousing agreement.

8.16 GMS' acquisitions caused Alan Thompson and GMS to breach rule 6. Alan Thompson increased his control of the percentage of voting rights in Kerifresh from 18.49% to 21.94%.

GMS found to be in breach of Code

8.17 GMS increased the percentage of voting rights in Kerifresh it controlled to 3.45%,which, when added to the percentage of voting rights held or controlled by GMS' associates Alan Thompson (18.49%) and Hamish McHardy (10.75%), exceeded 20%.

2005 – Anbran transfer and acquisition

8.18 In late 2005 GMS told Alan Thompson and Hamish McHardy it wanted to exit the GMS arrangement. Alan Thompson therefore settled the Anbran Trust to receive 245,000 Kerifresh shares acquired by GMS. Anbran Trustee Company Limited (**Anbran**) was trustee of the Trust. Its sole director and shareholder was Alan Thompson's niece, Emma Eastwood. The beneficiaries were Alan Thompson's children.

8.19 Anbran later acquired a further 116,000 shares to increase its shareholding to 361,000. These acquisitions were made from minority shareholders, funded by Hamish McHardy, thereby unwinding the balance of the warehousing agreement. The Panel considered that, at the time the warehousing agreement was unwound, Hamish McHardy and Alan Thompson ceased to be associates.

8.20 The Panel found that Emma Eastwood, as sole shareholder and director of Anbran, and appointer of the Anbran trust, controlled the Kerifresh shares acquired by Anbran.

Anbran an associate of Alan and Helen Thompson – Rule 4(1)(d)

8.21 The Panel considered that the personal, business and ownership relationships between Alan and Helen Thompson, Emma Eastwood and Anbran (including the fact that Alan Thompson made all the decisions regarding the Anbran Trust's investment in Kerifresh) were such that, under the circumstances of Anbran's acquisitions and holding of Kerifresh shares, they should be regarded as associates under rule 4(1)(d).

8.22 Anbran's acquisitions caused Anbran and Emma Eastwood to breach rule 6 of the Code. It increased the percentage of voting rights in Kerifresh held by Anbran and controlled by Emma Eastwood to 5.30% which, when added to the percentage of voting rights held or controlled by their associate Alan Thompson (19.26%), exceeded 20%.

2007– Lawrence Fletcher's proposed acquisition

8.23 Lawrence Fletcher was an acquaintance of Jonathan McHardy. In early 2007 he had money on deposit with the Murrayfield Trust as a result of a previous business venture with the McHardys. Jonathan McHardy suggested reinvesting those funds in Kerifresh. Law firm Grove Darlow & Partners acted for Lawrence Fletcher in the purchase of Kerifresh shares. In August 2007 Grove Darlow's trustee company GDP Trustee Limited acquired 10,000 Kerifresh shares on Lawrence Fletcher's behalf. Hamish McHardy initially funded that purchase. Lawrence Fletcher repaid him from some of the funds deposited with the Murrayfield Trust.

8.24 Lawrence Fletcher wished to purchase a further 500,000 Kerifresh shares. Alan Thompson had become aware that there may have been a breach of the Code in respect of the Anbran transactions, and that he should sell down shares to reduce his and Anbran's combined shareholding to less than 20%. Through Hamish McHardy, Lawrence Fletcher became aware of this and agreed to purchase 165,000 of Alan Thompson's shares. Grove Darlow then sent out a letter to shareholders offering to purchase the balance of 335,000 shares. Neither acquisition was completed because of restraining orders issued by the Panel.

Fletcher and McHardys considered associates

8.25 The Panel considered that Lawrence Fletcher, Hamish McHardy and Jonathan McHardy were associates under rules 4(1)(a) and 4(1)(d).

8.26 The Panel found that those persons were acting "in concert" in relation to Lawrence Fletcher's intended acquisitions and were associates under rule 4(1)(a). The evidence showed a clear understanding and purpose between the three of them that Lawrence Fletcher would increase his holding of Kerifresh shares by up to 500,000.

8.27 The Panel also found that they had personal or business relationships, such that, under the circumstances of Lawrence Fletcher's proposed acquisitions, they should be considered associates. Factors included previous business dealings and the common strategy to assist Lawrence Fletcher to acquire up to 500,000 shares in Kerifresh.

8.28 Lawrence Fletcher's proposed acquisition would have breached rule 6. It would have increased the percentage of voting rights in Kerifresh he held to 6.73% which, when taken together with the percentage of voting rights in Kerifresh held or controlled by his associates Hamish McHardy (10.72%) and Jonathan McHardy (8.41%), would exceed 20%.

Designer Textiles (NZ) Limited – Gould Holdings Limited - Control and Association

8.29 Designer Textiles (NZ) Limited (**DTL**) was a Code company. Its major shareholder was Gould Holdings Limited (**GHL**), an investment company controlled by Mr George Gould, with a 24.69% stake. Mr Gould had a long association with the Rutherford family. In the latter part of 2002, the members of the Rutherford family sold their investment company, Amuri Securities Limited (**ASL**) to GHL in exchange for shares and convertible notes in GHL. After Mr Gould had subscribed some additional capital in GHL the Rutherford family held 21.24% of GHL while Mr Gould, through a separate company Gould Investments Limited (**GIL**), held 78.76%.

8.30 The Panel was concerned that the Rutherford family interests may have joined Mr Gould in "holding or controlling" GHL's 24.69% stake in DTL in breach of the Code. The issue was the effect of rule 6(2)(b) which states that if:

> …
>
> *(b) a person or persons together hold or control voting rights and another person joins that person or all or any of those persons in the holding or controlling of those voting rights as associates, the other person is deemed to have become the holder or controller of those voting rights:*
>
> …

8.31 To come within rule 6(2)(b) the Rutherfords first had to have joined Mr Gould/GIL in the control of GHL and therefore the control of GHL's shareholding in DTL.

8.32 The Panel examined the relationship between the Rutherford family and Mr Gould to decide whether the Rutherfords may have joined Mr Gould/GIL in controlling GHL. Of particular note to the Panel were:

(a) the Rutherfords had no board representation on GHL;

(b) the Rutherfords acquired their interest in GHL accepting that they had no right to influence Mr Gould's control of that company; and

(c) there was no shareholder agreement to provide the Rutherfords with any control in the decision-making process of GHL.

8.33 The Panel accepted that the Rutherford family had not joined Mr Gould/GIL in the controlling of GHL's 24.69% holding in DTL. The Panel noted that it would be unusual for an investment of 21.24% to be made in a closely-held company on an entirely "sleeping partner" basis with no checks and balances on the conduct of that company.

8.34 However, in this case the evidence indicated that:

(a) Mr Gould was intent on retaining control of GHL; and

(b) the Rutherford family bought their shares in GHL accepting that they had no rights to influence GHL's governance, either in controlling the votes in DTL, or otherwise.

8.35 The second part of rule 6(2)(b) requires that parties are joined in the holding or controlling of the voting rights as associates. As the Panel determined the requirements of the first part of rule 6(2)(b) had not been met, there was no need to consider whether the Rutherfords and Mr Gould/GIL were associates.

8.36 The question of association between the Rutherford family and Mr Gould also arose in connection with various acquisitions of shares in DTL itself by members of the family.

8.37 Several family members had acquired direct investments in DTL and by February 2003 these holdings amounted to some 8.8% of the total voting rights in DTL. They were in addition to the 24.69% held by GHL. The issue was that if the Rutherford family were associates of Mr Gould or GIL at the time they had acquired these parcels of shares then the acquisitions would have been in breach of the Code.

8.38 The Panel considered a number of factors, including:

(a) the historical business relationship through companies in which both the Rutherfords and Mr Gould had an involvement;

(b) the Rutherfords had previously contracted Mr Gould to manage certain investments in ASL on their behalf;

(c) the Rutherford investment in GHL was very informal with minimum documentation and was characterised by a high degree of trust on the part of the Rutherford family;

(d) the Rutherford family agreed not to take part in the governance of GHL; and

(e) the relevant investment monies of the Rutherfords were kept together over many years, and they adopted a common approach to the investment in GHL.

8.39 The Panel was satisfied that the strands of all three elements (business, personal and ownership relationships) of the extended definition of "associate" in rule 4(1)(d) satisfied the requirements for association between Mr Gould and the Rutherford family. The rule 4(1)(d) relationships did not need to exhibit any agreement over control or any particular form of undertaking relating to the voting rights attached to shareholdings in the company. In particular, the expression "in the circumstances" enabled all factors to be considered in assessing the relationship, taking into account the importance of the associate status.

8.40 The Panel determined that the associate status crystallized on 11 September 2002 and that consequently all acquisitions of DTL securities by Rutherford family members after that date were in breach of rule 6(1)(a). The parties at fault were required to divest those holdings that had been acquired in breach of the Code. The family members gave enforceable undertakings that the relevant shares would be sold within six months of the Panel's decision and subsequently confirmed that this had been done.

8.41 Even small acquisitions of voting rights in a Code company can be in breach of the Code if an associate of the person acquiring the voting rights already holds more than 20% of the voting rights in the company. The provision is designed to ensure that controlling shareholders cannot increase their level of control in a Code company through associates when they would be unable to acquire the additional voting rights themselves.

Bridgecorp Capital Limited - Association

8.42 In late 2004 Bridgecorp Capital Limited (**Bridgecorp**) acquired 19.99% of the voting rights in Dorchester Pacific Limited (**Dorchester**) from Mr Brent King, the managing director of Dorchester, and from other interests. Mr King retained 5.05% of Dorchester and subsequently purchased a further 0.9% of Dorchester. Consequently Mr King and Bridgecorp held 25.94% of Dorchester between them. At the same time that Mr King and Bridgecorp entered into the sale and purchase agreement in respect of 19.99% of Bridgecorp, they also entered into an agreement described as a "lock-up deed" which was in substance an option deed.

8.43 To decide whether Bridgecorp and Mr King were associates, the Panel considered the facts around the entering into of each agreement and the expectation of the parties after the agreements. The sale and purchase agreement between Bridgecorp and Mr King provided for a number of ongoing relationships such as:

(a) an employment commitment by Mr King to remain as CEO of Dorchester for a period;

(b) a restraint of trade for Mr King, preventing any competition with Dorchester's business within 6 months of his leaving Dorchester's employment, should he do so; and

(c) a restraint on Mr King buying any more shares in Dorchester for 12 months.

8.44 The option deed provided for:

(a) the payment of $600,000 by Bridgecorp to Mr King for an option;

(b) a standstill on Mr King's shares (preventing him from selling his remaining Dorchester shares);

(c) an option (for 10 months) for Bridgecorp to purchase the remainder (5.05% of Dorchester's voting rights) of Mr King's Dorchester shares at a fixed price; and

(d) a commitment by Mr King to accept a possible future takeover offer by Bridgecorp (although Bridgecorp did not commit to making such an offer).

8.45 The Panel considered that as a result of these ongoing contractual provisions relating to the future control of voting rights in Dorchester and other commitments the parties were associates under the Code. Their combined holding of voting rights after the transactions exceeded the 20% threshold and consequently the acquisition of voting rights was in breach of the Code. After making its determination the Panel accepted enforceable undertakings from Bridgecorp to sell down approximately 5% of the voting shares of Dorchester and from Mr King to sell down approximately 0.9% of the voting shares in Dorchester. These sales put Bridgecorp and Mr King back in the position they would have been in had their acquisitions as associates complied with the Code. The two parties also undertook to unwind the option deed and elements of the sale and purchase agreement, thus removing contractual elements of their association.

Kiwi Income Property Trust/Sovereign Assurance Limited - Association

8.46 In November 2004 Kiwi Income Property Trust (**Kiwi**) acquired 19.9% of the voting rights in Capital Properties Limited (**Capital Properties**), a Code company, by way of a stand in the market.

8.47 Subsequently Sovereign Assurance Company Limited (**Sovereign**) (which was related to, and therefore associated with, Kiwi through common upstream ownership of Kiwi's management company) bought more Capital Properties shares on market, which increased the aggregate holdings of Kiwi and Sovereign to just over 20%. When notified of these acquisitions the Panel immediately contacted Sovereign seeking an explanation. Sovereign recognised its error and immediately sold down sufficient shares to reduce the combined holding of Kiwi and Sovereign in Capital Properties to below 20%.

Calgary Petroleum Limited - Association

8.48 A number of shareholders increased their voting rights in Calgary Petroleum Limited (**Calgary**) by taking up an overacceptance facility of a pro rata offer. Another shareholder complained to the Panel that these shareholders were associates because they had personal and business relationships, and had voted the same way on a resolution to remove a director of the company.

8.49 The Panel decided that a number of shareholders agreeing to exercise their votes in a particular way does not necessarily make them associates. The Panel considered the nature of the relationship between the shareholders and determined that they were not associated. Although many of the shareholders had personal and business relationships, in contrast to the Dorchester case, their relationships did not involve the control of voting rights in Calgary.

APPENDIX A
Examples of Declined Exemptions Involving Rule 6(2) of the Code

1 General Information

1.1 This part of the Guidance Note describes two applications for exemptions that were declined by the Panel on the basis that the relevant transactions involved did not infringe a deeming rule in rule 6(2) of the Code and therefore could be put into effect without the need for an exemption from the fundamental rule. The applications are illustrative of the Panel's interpretation of rule 6(2).

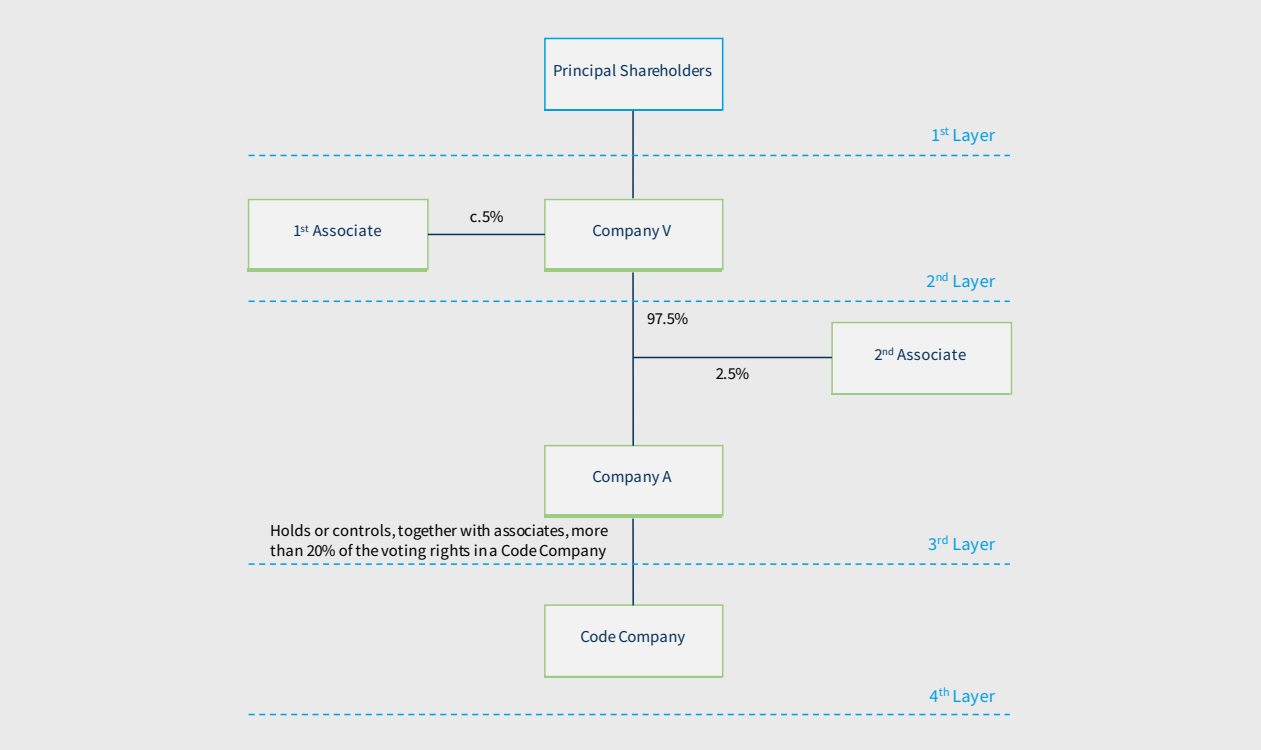
1.2 The names of the parties involved have been omitted to protect commercial confidentiality.

2 Restructuring of family investment structure – rule 6(2)(b) – joining in control as associates

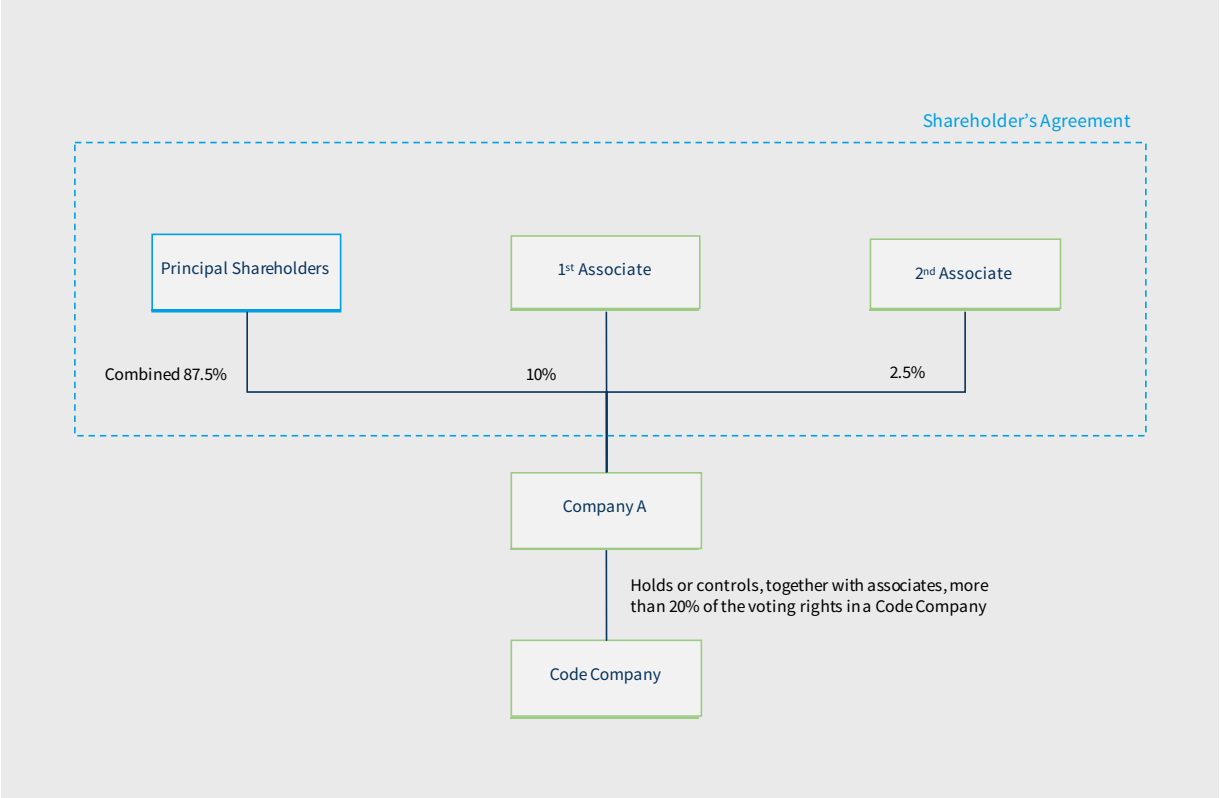
2.1 The diagrams below illustrate the transaction:

Example 1:

Pre-restructure



Post-Restructure



3 Background

3.1 The family's investment interest in the Code company was structured into four layers. The first layer essentially comprised separate entities which operated for the benefit of family members (the **Principal Shareholders**).

3.2 The Principal Shareholders held approximately 95% of the shares in an investment holding company, Company V (the second layer). The remaining 5% of the shares were held by an associate of the family (the **First Associate**). Company V held a range of different investments interests.

3.3 One of those interests was a 97.5% holding in Company A (the third layer). The remaining shares in Company A were held by another associate who was connected to the family (the **Second Associate**). Company A held or controlled, together with its associates, more than 20% of the voting rights in a Code company.

3.4 This structure effectively gave the Principal Shareholders control of more than 20% of the voting rights in the Code company.

4 Proposed restructuring

4.1 The family wished to simplify the structure. The proposed restructuring involved Company V disposing of its 97.5% interest in Company A to the Principal Shareholders and the First Associate. As a result, the Principal Shareholders would hold a combined 87.5% of the shares in Company A, the First Associate would hold 10% and the Second Associate would continue to hold 2.5%. The shareholders of Company A would then enter into a shareholders' agreement whereby (among other things):

(a) the director of Company A would be nominated by the Principal Shareholders; and

(b) Company A could not enter into significant transactions without the approval of the Principal Shareholders.

5 The Panel's decision

5.1 The Principal Shareholders sought an exemption from rule 6(1) of the Code to allow the restructuring without obtaining the approval of the shareholders of the Code company.

5.2 The Panel noted that the proposed restructuring was not going to result in the Principal Shareholders increasing the percentage of voting rights that they already controlled in the Code company. The issue for the Panel was whether the First Associate, by becoming a 10% shareholder in Company A, would be deemed by rule 6(2)(b) of the Code to increase its voting control in the Code Company above 20%.

5.3 Rule 6(2)(b) provides that if "*a person or persons together hold or control voting rights and another person joins that person or all or any of those persons in the holding or controlling of those voting rights as associates, the other person is deemed to have become the holder or controller of those voting rights*". The key consideration for the Panel was whether the First Associate was going *to join* the Principal Shareholders *in the control* of voting rights held by them in the Code Company. The Panel concluded that First Associate would not do so because of the shareholding agreement that was going to be put in place. Accordingly, rule 6(2)(b) did not apply.

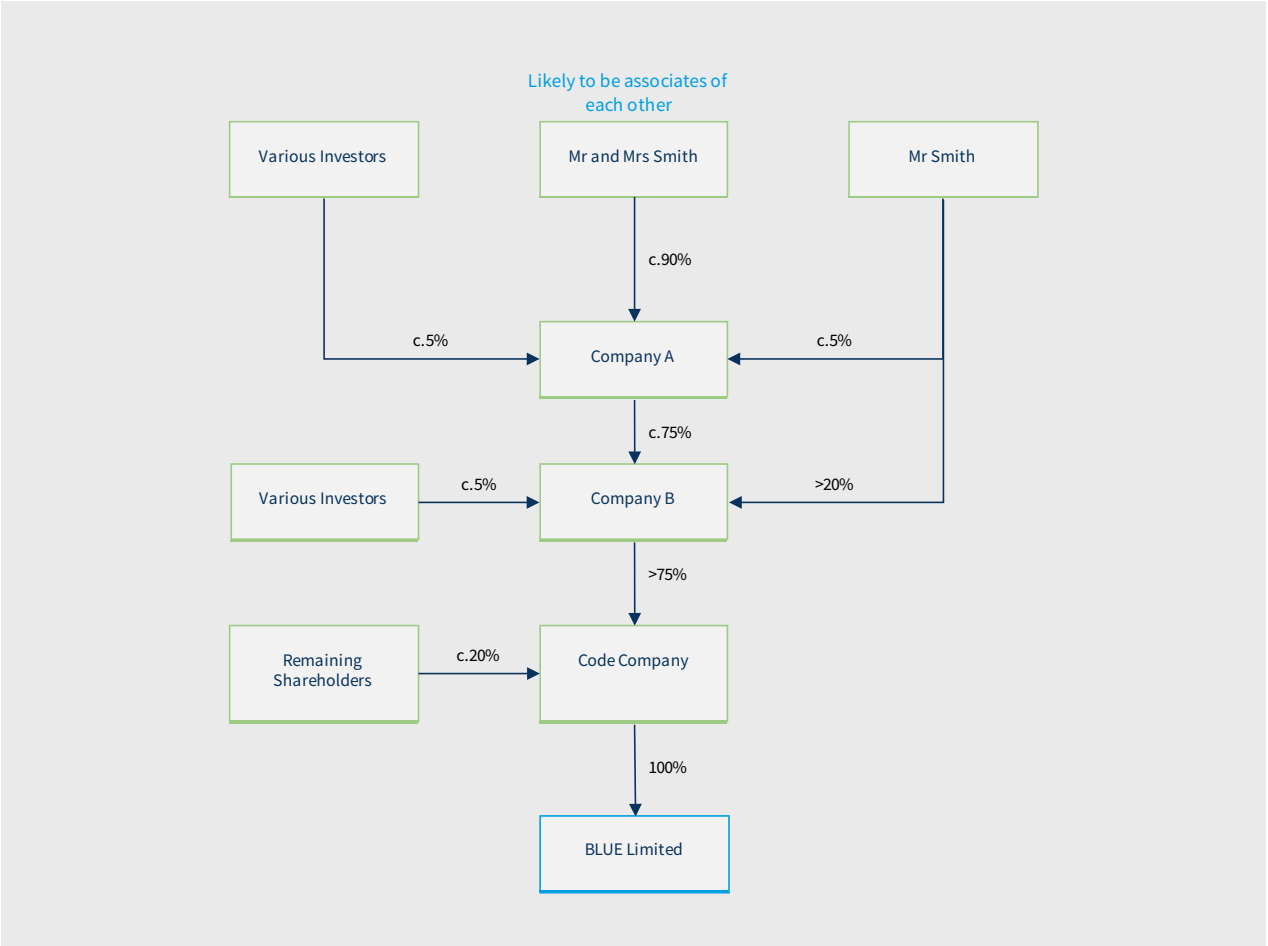
5.4 Given that no persons involved in the proposed restructuring transaction were going to be caught by the Code, the Panel declined to grant the application for an exemption, on the basis that no exemption was necessary.

6 Proposed merger – rule 6(2)(c) – upstream companies

6.1 The second example relates to proposed merger of two upstream companies. This is depicted below in Example 2.

Example 2:

Post-Merger



Background

6.2 Mr and Mrs Smith jointly held 90% of the shares in Company A. Mr Smith, held in his own name 5% of the shares, and the remaining shareholders of Company A were various other investors, all of whom were likely to have been associates of the Smiths for the purposes of the Code.

6.3 Company A held approximately 75% of the shares in another company, Company B. Mr Smith held 20% of the shares in Company B and the remaining shares were held by various investors. Mr Smith and these investors were all likely to have been associates of Company A and of the Smiths for the purposes of the Code.

Proposed transactions

6.4 Company B held all the shares in Blue Limited. It was proposed that Company B would merge with a Code company (the **Merger**). The proposed transaction would involve Company B selling all of its shares in Blue to the Code company and the Code company issuing shares to Company B as consideration for the shares in Blue. Company B would also subscribe for additional shares in Code company. It was expected that after the Merger, Company B would hold more than 75% of the Code company and that the remaining shareholders of the Code company would hold more than 20%.

6.5 Company A was also proposing to make an unrelated business acquisition (the **Proposed Acquisition**) following the Merger. To assist completion of this transaction, the Smiths intended to make a financial contribution into Company A which would result in the Smiths increasing their ownership of Company A by less than 1%.

6.6 Company A and Company B, the Smiths (together) and Mr Smith (together the "Applicants") were concerned that the Proposed Acquisition, and any potential future share transactions in Company A and Company B, would be caught by rule 6(1) of the Code. An exemption was sought from rule 6(1) in respect of the Proposed Acquisition so that the applicants could obtain certainty as to the application of rule 6(1) in the particular circumstances. The Applicants requested that the Panel decline the exemption on the express basis that the Code was not applicable to the circumstances.

6.7 The Applicants submitted that despite the Proposed Acquisition (or any other similar future transaction) the Smiths already controlled Company A and the less than 1% increase in the Smiths' shareholding in Company A would have no impact on the Smiths' effective control of the Code company if the Merger proceeded.

The Panel's decision

6.8 Rule 6(2)(c) appeared to be the only rule that may have applied to the proposed transactions. Rule 6(2)(c) provides that if "*voting rights are held or controlled by a person together with associates, any increase in the extent to which that person shares in the holding or controlling of those voting rights with associates is deemed to be an increase in the percentage of the voting rights held or controlled by that person*".

6.9 The issue in question was whether, as a result of the shareholding arrangements relating to Company A and Company B, the Smiths and the other investors would be regarded as sharing in the control of the voting rights in the Code company following the Merger. It was accepted by the Applicants that the Smiths and the other investors were likely to be associates of each other for the purposes of the Code.

6.10 If the Smiths and the other investors would be regarded as sharing in the control of the voting rights in the Code company, rule 6(2)(c) would apply to the proposed transactions, and would have the effect of preventing any of the shareholders in Company A and Company B from increasing their voting rights in Company A or Company B (except in accordance with the Code). This is because an acquisition of voting rights in Company A or Company B would result in the acquirer of those voting rights increasing the extent to which they shared in control of the voting rights in the Code company. Rule 6(2)(c) would deem that increase to be an increase in the acquirer's voting control in the Code company. That increase would be caught by the Code.

6.11 The Panel noted that there were no shareholder agreements in place in respect of Company A and Company B and that the shareholders in those companies only had their statutory rights as shareholders. Given the structure of Company A and Company B, the Panel considered that the Smiths had complete and unfettered control over Company A and likewise, Company A and the Smiths (together) had absolute control over Company B. Once the Merger was complete, the Smiths would, in turn, control the voting rights held by Company B in the Code company. Furthermore, the Panel considered that the minority shareholders in the upstream companies (Company A and Company B) did not appear to have any share in the control of the voting rights of those upstream companies, and therefore the Smiths would not share control of the voting rights in the Code company with those minority shareholders as contemplated by rule 6(2)(c) of the Code.

6.12 For these reasons, the Panel declined the application for an exemption on the basis that the Code did not apply so no exemption was necessary.