

16 December 1985

REPORT OF THE SECURITIES COMMISSION

ON AN ENQUIRY INTO

DEALINGS IN THE SHARES OF EMCO GROUP LIMITED

ON THE NEW ZEALAND STOCK EXCHANGE

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REPORT OF THE SECURITIES COMMISSION ON AN ENQUIRY INTO
DEALINGS IN THE SHARES OF EMCO GROUP LIMITED ON THE NEW
ZEALAND STOCK EXCHANGE

1. On 15 August 1985 the Securities Commission announced that it had decided to undertake an enquiry into dealings in the shares of EMCO Group Limited in the period Monday, 4 March to Friday, 12 July. This decision was taken following a request from the New Zealand Stock Exchange which had drawn attention to certain practices relating to securities which it had observed in this period. The terms of reference for the enquiry are annexed to this report marked "A".
2. While the terms of reference for the enquiry were widely drawn the primary matters of interest to the Commission were:
 1. The circumstances and the terms of the sale by the AMP Society to Giltrap interests of a large parcel of EMCO shares held by them, including, in particular, the terms of any fee and of any escalation clause.
 2. The terms of the transactions, both buy and sell, entered into by Giltrap interests including, in particular, the terms of any escalation clauses, and
 3. The extent to which the information on the above transactions as communicated to the New Zealand Stock Exchange ensured that the market was properly informed as to the terms of the contracts.
3. The Commission held a public hearing at its offices in Wellington on Friday, 16 August. Evidence was taken from:

Mr P.A. Randall,
Manager, Share Investments,
AMP Society

Mr Bruce Hancox,
Chief Executive,
Brierley Investments Limited

Mr I.L.G. Stewart,
Partner,
Frank Renouf & Co.

Mr B.E. Johnson,
Partner,
Jarden & Co.

Mr R.W.B. Gill
Executive Director,
New Zealand Stock Exchange

Mr D.C. Thurston,
Chief Executive,
Steel & Tube Holdings Limited

Mr I.K. Alexander,
Company Secretary,
EMCO Group Holdings Limited

Subsequently on 17 October evidence was obtained from Mr C.J. Giltrap of Giltrap Group Holdings Limited. Counsel appeared for witnesses as follows:

Mr C.R. Carruthers for AMP Society

Mr W.M. Wilson for Jarden & Co.

4. A draft of this report was prepared for consideration by the Commission and those who had given evidence. The Commission considers that all parties have had an adequate opportunity to present their evidence and their views to the Commission.

I. STATEMENT OF FACTS*

5. On 6 March 1985 Brierley Investments Limited ("Brierley") applied to the Examiner of Commercial Practices for consent to acquire all of the issued capital of EMCO Group Limited ("EMCO"). At that time the issued capital of EMCO comprised 31,270,000 \$1 ordinary shares and 6,000,000 \$1 16% specified preference shares. On 16 April 1985 the Examiner notified his consent to the application.
6. On 17 April 1985 Brierley gave notice to EMCO of an unconditional offer in cash to purchase all the issued capital of EMCO. Brierley directors informed the New Zealand Stock Exchange ("the Exchange"). Sharebrokers, Jordan Sandman Smythe, informed the Exchange that they had been:

"instructed by Brierley Investments to buy 20 per cent EMCO's capital or approximately 7,000,000 shares at \$2.90 for ordinary shares and \$1.70 for the specified preference shares".

On the same day the EMCO Board announced that they considered the offer "far too low" and advised shareholders not to sell. Brierley increased their offer to \$3 for each ordinary share and \$1.80 for each specified preference share. They also instructed brokers to inform sellers that "should they pay a higher price in the market or should they increase their cash takeovers offer, you will be covered for any such increase".

*Footnote

The texts of all announcements quoted in this section and the dates ascribed to them are as reported in the New Zealand Stock Exchange Daily Memo

7. On 17 April AMP sold to Brierley by private treaty 1,650,000 ordinary shares at a price of \$3 each, subject to escalation. Other institutions sold shares to Brierley on similar terms.

8. On 19 April 1985 sharebrokers, Frank Renouf & Co. ("Renouf") reported that they had been:

"instructed by Steel & Tube Holdings Limited to stand in the market for up to 19.9% of EMCO Group Ltd's share capital at a price of \$3.40 for the ordinary shares and \$2.20 for the convertible preference shares".

9. On 26 April 1985 sharebrokers, Jarden & Co ("Jarden") announced that they had:

"completed their order for EMCO shares on behalf of an unnamed client who holds in excess of 10% of the capital of EMCO".

It was subsequently disclosed that Jarden had been buying on behalf of Giltrap Group Holdings Limited and associated interests ("Giltrap").

10. On 26 April 1985 the EMCO Board announced that it had decided to make a 1 for 5 bonus issue of ordinary shares on 24 May to all ordinary shareholders on the register on 13 May. Holders of specified preference shares would participate in the bonus issue on conversion.

11. On 6 May 1985 Brierley announced that:

"As a result of the 1 : 5 bonus issue and dividend announced by directors, [of EMCO], Brierley is not proceeding with the offer to all shareholders which was lodged with EMCO on 17 April 1985".

12. On 7 May 1985 Renouf advised that Steel & Tube Holdings Limited ("Steel & Tube") had:

"acquired 4,616,611 EMCO ordinary shares and 854,832 specified preference shares.

This represents 14.74% of the share capital. Steel and Tube have now withdrawn from the market".

13. On 24 May 1985 EMCO made a one for five bonus issue pursuant to which a further 6,253,862 ordinary shares were issued.

14. On 5 July 1985 Steel & Tube announced that it had:

"concluded arrangements with Brierley Investments Ltd and Giltrap Group Holdings Ltd to acquire all the shares owned by them in EMCO Group Limited ...

"As Steel & Tube already owns 15% of EMCO these purchases will increase its shareholding in that company to approximately 65%...

"There are no immediate plans for further acquisitions of EMCO shares by Steel & Tube although Commerce Commission consent to acquire 100% is held".

II THE SALE OF EMCO SHARES BY AMP SOCIETY

15. As at 4 March 1985 AMP Society (AMP) held fractionally over 10% of the issued share capital of EMCO Group Limited (EMCO). This comprised 3,262,542 ordinary shares and 390,190 specified preference shares. They sold this holding in two transactions.
16. In the first transaction, AMP agreed, on 17 April 1985, to sell to Brierley 1,650,000 ordinary shares at a price of \$3 a share, subject to escalation. Settlement was made on 19 April. The terms of the escalation clause were not stated in a single piece of paper but the following, contained in a Brierley letter of 30 April, appears to have been the operative words:

"Whatever price our [Brierley] bid may finally be made at, we would ensure that the AMP would immediately receive the same price".
17. The second transaction was concluded towards the end of April. Steel & Tube came into the market seeking 19.9% and another at that stage unidentified party was seeking some 11%. Renouf were acting for Steel & Tube. Jarden were acting for the, at the time, unidentified Giltrap. In the context of the holdings which were now being sought AMP's holding was considered, both by AMP and by the two bidders, to be "strategic". AMP received offers from both parties in the period 23 and 24 April but did not sell.
18. On 26 April 1985 Jarden, on behalf of Giltrap, made an offer to AMP of \$3.50 plus 10¢ fee for each ordinary share and \$2.25 plus 15¢ fee per share for each specified preference share, together with an escalation

clause, described by both Jarden and AMP as "generous", as follows*:

"Escalation provisions are that if prior to 24.7.85 (3 months from this date):

- a) There are sales of more than one million shares recorded at a price higher than \$3.50 for ordinary or \$2.25 for the specified preference shares; or
- b) There is a formal and successful takeover at a higher price; or
- c) If [Giltrap] pay a higher price to anyone else; or
- d) If the shares purchased from [AMP] are sold to another party at a higher price;

Then the difference between the higher price and the \$3.50 paid on the ordinary shares (1,612,542) and \$2.25 on the specified preference shares (390,190) sold by you will be paid within 7 days of the event occurring with respect to A and C and settlement in the case of B or D. The difference will be discounted by 24.75% per annum to the date of payment."

Renouf, on behalf of Steel & Tube, also made what was described as "its best offer" to AMP. AMP decided that the Jarden offer was "more advantageous than the Renouf offer" and accepted the Jarden offer.

19. The price was reported to the Exchange on 26 April, at \$3.50 for each ordinary share and \$2.25 for each preference share. No reference was made to the fee or the escalation clause in the report. Other sales were reported on the Exchange on 26 April at \$3.42 and \$3.45 for the ordinaries and \$2.25 for the preference shares. Sales were reported on 29 April at \$3.50 and \$3.51 for the ordinaries, with late sales at \$3.45.

*Footnote.

The text of this escalation clause is recorded in a letter from Giltrap to AMP dated 24 April 1985 and received by AMP some time on 26 April 1985.

II Other transactions by Giltrap

20. In the period 24 April to 30 April Giltrap acquired a total of 4,223,186 ordinary shares and 647,716 specified preference shares. All shares were bought through Jarden. No consideration other than a price per share unit (for example a fee or an escalation clause) was paid or given other than in respect of the AMP purchase. Following the 1:5 bonus issue Giltrap held 5,067,823 EMCO ordinary shares.

21. On 5 July 1985 Giltrap agreed to sell to Steel & Tube all ordinary and preference shares in EMCO of which it had beneficial ownership, namely, 5,067,823 ordinary shares and 647,716 preference shares. Settlement was made on 12 July 1985. It is understood that the provisions of the agreement between AMP and Giltrap relating to escalation applied to this transaction to the effect that Giltrap was required to make an additional payment to AMP.

IV Reporting of Sales to New Zealand Stock Exchange

22. Neither the fee nor the escalation clause contained in the AMP/Giltrap contract was reported to the Exchange. The escalation clause in the AMP/Brierley contract was not reported to the Exchange by brokers as a term of sale. Any additional payment made by Giltrap to AMP following the Giltrap/Steel & Tube agreement was not reported to the Exchange.
23. The Regulations of the New Zealand Stock Exchange contain the following provisions relating to Sales Reporting:

34.07 All sales of shares or fixed interest securities in marketable parcels must be reported in writing to a member's regional exchange.

34.08 Sales made before 3.30 p.m. on any trading day shall be reported on that same day and sales made after 3.30 p.m. on any trading day shall be reported as "late" sales before 9.30 a.m. on the next trading day.

34.09 Notwithstanding regulation 34.08 sales not made at an official trading session shall be reported before the beginning of the next trading session.

34.10 Any sale made outside the range of quotations for a particular security on the day on which the sale was made or on different terms from sales made on the trading floor on that day shall be reported as a "special" sale.

34.11 If a sale is "special" because of the terms being different from those

applying to sales on the trading floor on that day, then the report of the sale must include details of such terms.

24. The Listing Requirements of the New Zealand Stock Exchange impose sales reporting obligations on listed companies. Paragraph 509(3) provides:

"A listed company upon disposing of or acquiring, by whatever means, a beneficial interest in 5% or more of the issued shares of another listed company, is to advise the Exchange immediately by telecommunication stating the following:

- (i) the name of the company
- (ii) the number of shares involved (with a class by class breakdown if more than one class is represented)
- (iii) the percentage of issued share capital in each class represented
- (iv) the price per share - (if more than one price is paid or received, the announcement shall state the range of prices paid or received with an average price if such a figure can be calculated).

Further acquisitions or dispositions of 1% or more of such shares must also be reported in the same way until the total beneficial interest is reduced to less than 5%."

The Listing Requirements also impose an obligation on a target company to report the terms of any takeover offer whether by a listed or a non-listed company.

25. The Commission considered:

- a) whether an escalation clause of the type included in the AMP/Giltrap agreement or the AMP/Brierley agreement was a term or sale for the purposes of the Exchange's regulations on reporting;

- b) whether the fee in the AMP/Giltrap agreement was a term of sale for reporting purposes;
 - c) whether the information as reported to the Exchange ensured that the market was properly informed as to all important terms and conditions of contract;
 - d) whether it was necessary to recommend any changes in the Exchange's regulations to ensure more complete reporting.
26. The practice of the Exchange has been not to require the reporting of an escalation clause and these have not been reported. There appeared to be some doubt in Mr Gill's mind whether this was covered by his regulations, particularly where, as in the Brierley transaction, the buyer was not called on to make a payment under the clause. The Commission considers that an escalation clause is a term of sale for the purposes of the regulations, at the time of the sale and irrespective of whether or not an obligation arises in any case. In the case of the two AMP transactions it was an important term, one of profound interest to the contracting parties and to the market generally. On a correct interpretation of regulation 34.11, in the Commission view, the reports of the two sales should have included details of the relevant escalation clauses.
27. In the view of those who gave evidence to the Commission the practice of requiring a fee, premium or other consideration in addition to a price per share unit is not wide-spread. The concerned parties disagreed as to the nature of the fee in the AMP/Giltrap agreement. The following extract from the notes of evidence records Mr Randall's (AMP) understanding:

"Randall: AMP then on Friday 26 April 1985, went back to Jardens and asked for its best

offer. Jarden's, Mr B.E. Johnson, asked whether AMP would accept a price and a fee. AMP said that it was not concerned as to how its price was paid. All it was interested in was the end result for its policy holders. In response, Jarden's made a firm offer of \$3.50 plus 10¢ fee on each ordinary share, and \$2.25 plus 15¢ per share on each specified preference share, and a generous escalation clause which had been offered previously.

Chairman: Yes. Just a moment. I'd like to understand that quite clearly. What was the fee for?

Randall: I did not enquire as to the purpose of the fee. My main concern was purely on the total price that was received. I did not make any enquiry on that.

Chairman: So far as you were concerned, then, were you getting \$3.60 per ordinary share?

Randall: Correct.

Patterson: And \$2.40 per preference share?

Randall: That is correct, Mr Chairman."

28. The Giltrap letter of 24 April (see footnote on page 7) reads:

"Further to our negotiations with you for the purchase of:

1,612,542 EMCO ordinary shares; and

390,190 EMCO Specified Preference shares,

we wish you to confirm acceptance of the following terms and conditions.

1. Purchase price \$3.50 for the ordinary shares and \$2.25 for the specified preference shares.
2. Cash payment on receipt of acceptance of this letter and transfers and certificates to our broker, Jarden & Co.
3. Escalation provisions are ...

We confirm the payment of a non-refundable amount of \$219,491.00 pending your acceptance of the terms and conditions"

29. The fee of 10¢ per ordinary share and 15¢ per specified preference share was paid by two separate cheques, for \$160,854 in respect of the ordinary shares and \$58,637 in respect of the specified preference shares (a total sum of \$219,491), on 1 May 1985.
30. The following extract from the notes of evidence records Mr Giltrap's reason for proposing a fee as a condition of contract:

"Giltrap: Well, I can't really say why I did that. But I did it at the time. I wasn't sure that there wasn't still a 1 or 2% parcel still held by, I think, it was GLO, and I thought at the time it might be better if that's the maximum he (Jarden & Co.) has paid to the other institutions. Obviously if another institution saw 355 or 360 they might sell, they obviously want one or two cents more. As we all know.

Chairman: So would you say it would be putting it a bit bluntly but fairly if we were to say that the reason for the payment of the fee was to avoid disclosure of a higher price than the \$3.50 per ordinary share to other possible vendors.

Giltrap: Correct. Plus there was also the possibility I didn't want to get into a Dutch auction".

31. Mr Johnson said in evidence:

"The fee was in the nature of an option fee, because it ensured that Mr Giltrap would be able to purchase the AMP shares provided that agreement could be reached on the terms of purchase".

32. The Commission does not believe this was the case. The Giltrap letter of 24 April contains Giltrap proposals. The terms of the contract were settled in discussions on 26 April. No commitment had been entered into by either party prior to 26 April. No payment was made by Giltrap in respect of the fee until 1 May. While it may have been Mr Johnson's objective to seek an option the evidence before the Commission was inconsistent

with his contention that his client had been given an option or a preliminary commitment of any other type. In the Commission's view the fee was a term of the contract under which AMP sold and Giltrap purchased the AMP shares. It was a term of sale.

33. On his obligation to report the sale Mr Johnson had this to say:

"We decided that the fee did not form part of the agreed price per share, and should not therefore be incorporated in the price of those shares. Accordingly, the only basis on which the sale could be accurately reported was the price per share which had been offered by Mr Giltrap and accepted by the AMP, which was the \$3.50 and the \$2.25 for the preference shares. Those prices were also recorded in our contract notes as being the prices for the sale, and were the basis on which stamp duty was calculated and paid - and also commission, Mr Chairman.

The question of the appropriate price at which to report a sale has become an increasingly difficult one, as the terms of sale have become more complex. For example, a sale with a deferred settlement date is effectively being made at a significantly lower level than the nominal price per share, because the purchaser continues to have the use of the money for the period of the deferment, and conversely the vendor does not have the use of that money for that period. Particularly at times of high interest rates, this is an important factor. Similarly, the existence of an escalation clause may mean that even by the time the sale can first be reported - for example, a sale made after the exchange closes one day and reported the next morning the true price is significantly higher than the nominal price. In these situations, my firm and, I believe, brokers generally, have taken the view that the only certain price, and therefore the appropriate price to be reported, is the price per share nominated in the contract."

34. In the Commission's view the test for a member of the Exchange to apply in deciding whether to report a

contractual provision is not whether it forms part of the agreed price per share but whether it is a term of the sale. If there were any doubt about this in the past the Exchange has clarified the position by amending its regulation 34 with effect from 16 September 1985:

- a) By making the following addition to paragraph 34.11:

"Without limiting the generality of this regulation, examples of sales which would require to be reported as special would be contracts made in conjunction with the payment of some other fee or consideration to either party, contracts made subject to any price escalation clause which was not being offered in identical terms to every seller in the market or contracts containing any term or benefit which was not being offered to the market as a whole."

and,

- b) By adding the following new paragraphs:

"34.12 In the event that a general escalation is paid to every seller after sales at a lower price are reported, the buyer broker shall advise the Exchange of the higher price paid to the sellers, including any transaction for which he is also the selling broker.

34.13 Where any market offer involves an escalation clause or any agreement to pay a fee or other consideration in addition to the reported sale price, the buying broker shall provide details of such escalation clause or agreement to the Executive Director on a confidential basis. The Exchange shall not publish such details without the consent of the offeror".

35. The Exchange establishes market prices for securities on a daily basis. It is important to investors and to listed companies that prices should be reported fairly and efficiently. It is a trite observation that a

market must be informed to be efficient. Mr Johnson has pointed out that shares may be transferred in transactions of great variety and considerable complexity. The Commission sees no worthwhile advantage in proscribing particular types of transactions from the Exchange. This would have the effect of driving sales off the Exchange. In respect of a transaction of the type of the AMP sale to Brierley the selling broker is required to report both the price and the fact of the escalation clause. In respect of a transaction of the type of the AMP sale to Giltrap the selling broker is required to report the price inclusive of the fee and the fact of the escalation clause.

36. There is a residual question. There should be a procedure for ensuring that the terms of sales of listed securities in respect of which the seller or his representative is not bound by the Rules of the Stock Exchange are reported to the Exchange. Many transactions, for example, the sale of EMCO shares by Brierley and Giltrap to Steel & Tube in July 1985, although reported under the rather more general provisions of the Listing Requirement 509, are not required to be reported promptly to the market. Many transactions handled by the principals thereto or by licensed sharebrokers, for example, merchant banks, who are not members of the Exchange, are not reported at all. An informed market requires that the public should know the terms of sales of listed securities, whether handled by members or not. The mechanism for ensuring this in respect of private off market sales does not exist. We have recommended a procedure to the Minister of Justice for enactment by legislation to secure the reporting of such transactions where substantial shareholdings are involved. The Exchange should explore other ways of encouraging a more wide-spread sales reporting practice. The Commission endorses the policy objective of the Exchange, as stated in its 1984 Annual Report (page 6), of seeking:

"... the reporting of all sales transactions to the Exchange, whether or not they take place inside the Exchange. This is an essential step towards ensuring that the market is better informed than it is at the present time."

for SECURITIES COMMISSION



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