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SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE COMPANIES

EXPLANATORY MEMORANDUM

RECOMMENDATIONS MADE TO

THE MINISTER OF COMMERCE BY

THE TAKEOVERS PANEL

CONTENTS

INTRODUCTION

1. On 27 March 2007 the Minister of Commerce asked the Panel to advise her on the issue of amalgamations and schemes of arrangement under the Companies Act 1993 (the "reconstruction provisions") involving companies that fall under the Takeovers Code. This followed the Panel's June 2006 discussion paper on the matter, and the Panel's subsequent recommendations to the Minister and to the Commerce Committee which was considering the 2006 Business Law Reform Bill.

2. In response to the Minister's request the Panel issued a new discussion paper on 5 December 2007 to seek the market's views on the Panel's assessment of the issue and on the merits of the proposals outlined in the paper ("the 2007 discussion paper"). Submissions were requested by 15 February 2008.

3. The Panel received 16 submissions on the 2007 discussion paper. Feedback has been used to assist the Panel to settle on a preferred option to deal with the cross-over between the reconstruction provisions and the provisions of the Code.

4. On 16 May 2008 the Panel recommended to the Minister the changes to the law that are discussed in this Explanatory Memorandum.

EXECUTIVE SUMMARY

5. In a change of control involving a Code company the bidder, and some shareholders in, and the Board of, the target company can, and sometimes do, structure takeover bids in such a way that the Code will not apply to the transaction, using provisions in the Companies Act.

6. There is a concern, expressed by some market participants and commentators and shared by the Panel, about how this might affect shareholders and the integrity and competitiveness of the New Zealand capital market.

7. While the Panel accepts that schemes and amalgamations are appropriate and necessary vehicles for carrying out some company reconstructions and mergers (with proper safeguards for shareholders) the current situation where the Code can be avoided (and the consequent loss of the express protections extended by the Code) through the way a deal is structured is of concern to the Panel. This is the same concern recognised in other 'code' jurisdictions which expressly provide regulatory overview of schemes that are used to effect changes of control of companies that are subject to a takeovers code.

8. The Panel's 2007 discussion paper proposed the following options for changing the status quo:

(a) Option 1 – Court approval required for amalgamations and schemes, with Panel input.
(b) Option 2 – Statutory exemption from Code.
(c) Option 3 – Align Companies Act's thresholds and disclosures with the Code.
(d) Option 4 – Prohibit Part 13 amalgamations in respect of Code companies.
(e) Option 5 – Prohibit schemes and amalgamations in respect of Code companies, unless the Panel permitted their use.

9. After careful analysis and consideration of the feedback received in response to the 2007 discussion paper, and further research, the Panel's preferred option is a combination of Options 1, 2 and 4 (with some refinements) from the 2007 discussion paper. The Panel's preferred option is that the Companies Act 1993 would be amended so that:

(a) A provision is inserted into Part 15 (Schemes of Arrangement), under which the Court would be prevented from approving a scheme that would have any effect on the voting rights of a Code company unless;

- the Court is satisfied that the shareholders of any such Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code, or

- there is produced to the Court a statement in writing by the Panel stating that the Panel has no objection to the scheme of arrangement.

However, the Court need not approve a scheme even though a statement by the Panel, stating that the Panel has no objection to the scheme, has been produced to the Court.[1]

(b) Voting thresholds, for the shareholder resolutions to approve of the scheme are stipulated, so that for the resolution to be passed –

(i) Those voting in favour represent 75% of the votes cast on the resolution at each meeting of shareholders (see (c) below);

[1] This proposal is similar to that found in section 411(17) of the Australian Corporations Act 2001 (Cth), which provides that:
(17) The Court must not approve a compromise or arrangement under this section unless:
(a) it is satisfied that the compromise or arrangement has not been proposed for the purpose of enabling any person to avoid the operation of any of the provisions of Chapter 6 [i.e., the takeovers provisions]; or
(b) there is produced to the Court a statement in writing by ASIC stating that ASIC has no objection to the compromise or arrangement;
but the Court need not approve a compromise or arrangement merely because a statement by ASIC stating that ASIC has no objection to the compromise or arrangement has been produced to the Court as mentioned in paragraph (b).

(ii) Those voting in favour represent a majority of the shares eligible to be voted (i.e., more than 50% of total voting rights of the company); and

(c) The voting threshold in sub-paragraph (i) above must be obtained at each meeting of each group of shareholders (as determined by the Court under section 236(2)(b) of the Companies Act as being an interest class for the purposes of voting on the resolution);

(d) Guidance for the Court should be included in Part 15 of the Companies Act on how to determine interest classes, for example by codifying the principles of the common law for determining those classes;

(e) The use of the Companies Act Part 13 long form amalgamation, under section 221, should be prohibited where an amalgamating company is a Code company, but the availability of the short form amalgamation under section 222 should be preserved for all companies.[2]

10. The Panel also proposes that the Takeovers Act and the Code should be amended to provide a statutory exemption from the application of the Code where Code companies are involved in a scheme of arrangement under Part 15 of the Companies Act if the Panel has provided a "no-objection" statement for production to the Court.

11. The Panel will develop and publish information about the criteria it would apply for the giving of a "no-objection" statement. Although the policy development on these criteria is yet to be undertaken, they are expected to include the following:

- the information proposed to be given to shareholders must meet disclosure standards similar to those required by the Code (including an independent adviser's report prepared by an adviser approved by the Panel); and

- any interest classes amongst the shareholders must be satisfactorily identified in accordance with the guidance on determining interest classes that will be included in Part 15 of the Companies Act (see paragraph 9(d), above,) for the purposes of shareholders voting on the scheme.

12. The Panel will also publish guidance for the market on the timing of the giving of "no-objection" statements *vis-à-vis* the Court processes for schemes, on how to obtain a "no-objection" statement, and on any fees for making "no-objection" statement applications. Promoters of the scheme would be encouraged to liaise closely with the Panel over these issues before applying to the Court for initial orders for the scheme.

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[2] Section 222 amalgamations relate solely to reorganisations of wholly owned subsidiaries. For Code companies wishing to be involved in an amalgamation not covered by section 222, this could still be achieved under the scheme of arrangement procedure; see paragraphs 67 – 70 below.

13. In order to ensure that the preferred option is effective and efficient in practice, it is hoped that a wide range of interested parties will participate fully during the Select Committee process, after the Bill is introduced into the House.

STATUS QUO AND PROBLEM

14. At various times over the past several decades in New Zealand concerns have been raised about the use of different procedures that regulate changes in control of companies. Before the Takeovers Code was introduced, there was considerable concern about how this impacted on shareholders' and local and international investors' confidence in the integrity of the New Zealand market.

15. Prior to the introduction of the Code, with some exceptions for listed companies, control of companies could pass, through the sale of the shares of one controlling shareholder to another. This could occur without the knowledge or participation of the minority shareholders.

16. The Takeovers Act was passed in 1993. The provisions of the Code were introduced in 2000 and came into force in July 2001.

<u>Status Quo: The Takeovers Act and Code, and the Companies Act 1993</u>

Takeovers Code

17. Companies that have voting securities listed with a registered exchange, or that have 50 or more shareholders named on their share register, are 'Code companies' which are subject to the specific protections, provisions and procedures of the Takeovers Code. The fundamental rule of the Code (rule 6) prohibits changes in control arising from the increase in the holding or controlling (together with associates) of more than 20% of the voting rights in a Code company.

18. The fundamental rule is subject to a limited number of exceptions set out in rule 7. These exceptions permit changes of control which may arise from the increase in the holding or control of voting rights above the 20% level. These exceptions may take the form of Code compliant offers (which may be partial or full offers), selective acquisitions or allotments.

19. The Code sets out procedural rules for conducting the change of control and prescribes in detail the information that must be provided to shareholders for any of these transactions. This information includes prescribed disclosures by the acquirer, a recommendation by the Board of the target Code company (and prescribed disclosures about the target company's involvement with the acquirer), and a report from an independent adviser on the merits of the transaction for the shareholders. The Takeovers Panel monitors the process and the information, for compliance with the Code, including the approval of the independent adviser.

20. For an acquisition or allotment of a parcel of shares under rule 7(c) of the Code (a purchase of a parcel of shares) or rule 7(d) of the Code (an allotment of

shares), the non-acquiring shareholders must approve of the transaction by ordinary resolution, and the acquirer and its associates cannot vote to approve of the transaction. For a takeover offeror to be able to take up any of the shares under a rule 7(a) (full) or (b) (partial) takeover offer, it has to have received sufficient acceptances to take its control position to more than 50% of the target company (or have shareholder approval for a lesser percentage). In order to compulsorily acquire any shares under the Code, the acquirer has to already have obtained 90% or more of the shares in the Code company.

Schemes of arrangement and amalgamations under the Companies Act

21. The reconstruction provisions of the Companies Act (Parts 13 (amalgamations) and 15 (schemes)) also provide mechanisms which can be used to effect a change of control of a company.

Amalgamations under Part 13 of the Companies Act

22. An amalgamation under Part 13 of the Companies Act permits two or more companies to combine to form one company if the proposed amalgamation is approved by the Board of each company and if the amalgamation proposal is also approved at a meeting of shareholders of each amalgamating company. Combining of the companies may effect a simple pro-rata merger of all the shareholding interests. Alternatively, it may be structured to effect a change in the control of the shareholding interests, resulting in a non pro-rata outcome where one or more shareholders increase their control position in the amalgamated company, resulting in the rest having their control positions reduced or even the complete exit of the company by the other shareholders.

23. The amalgamation proposal must be approved by shareholders representing 75% of the shares held *by those who vote* on the proposal. Section 221 of the Companies Act sets out some particulars of information that must be provided to shareholders, including a copy of the amalgamation proposal, a statement about the “minority buy-out rights” available under section 110 of the Companies Act for shareholders that vote against the proposal, and such further information and explanation as may be necessary to enable a reasonable shareholder to understand the nature and implications for the company and its shareholders of the proposed amalgamation.

24. The Companies Office ensures that all of the procedural requirements of Part 13 are met before registering the amalgamation proposal. However, this is an *ex post* review, as the amalgamation proposal is only received by the Companies Office after the proposal has been approved by the shareholders of the amalgamating companies. The Companies Office reviews the amalgamation proposal to ensure that it contains the particulars required by section 220 of the Companies Act and that the requisite certificates have been signed by the companies’ Boards. However, there is no third-party review of the standard of information provided to shareholders.

25. If a Code company is involved in the amalgamation, the amalgamation may be structured so that the Code company will be removed from the Companies

Office Register and the "acquiring" shareholder will continue as the holder of shares in an entity that is not a Code company. Such changes of control do not appear to have consequences under the Code.[3] Recent examples of such amalgamations include the amalgamation of Waste Management New Zealand Limited (Waste Management) and Transpacific Industries Group (Transpacific), and the amalgamation of Humanware Limited and Jolimont Capital.

Schemes and amalgamations under Part 15 of the Companies Act

26. An amalgamation, or some other restructuring of a group of companies, can also be undertaken under the "scheme" provisions of Part 15 of the Companies Act. Schemes are supervised by the High Court.

27. There are common law rules on the information that must be provided to shareholders. The Court is able to review the scheme documentation before it is put to shareholders. Usually only the promoters of the scheme appear at the initial hearing where that documentation is put to the Judge for approval. The common law has consistently required that the scheme be approved by shareholders representing 75% of the shares held *by those who vote* on the proposal.

28. A scheme of arrangement under Part 15 of the Companies Act, as with an amalgamation under Part 13, will only have a Code consequence if it results in a person becoming the holder or controller of more than 20% of the voting rights in a Code company during the reconstruction process or after the scheme has taken effect. If a scheme is structured so that no person becomes the holder or controller of voting rights in the Code company, the Code will not apply. An example of such a scheme was the merger of Independent Newspapers Limited (INL) and Sky Network Television Limited (Sky), through a new company that was formed to effect the scheme, and where the voting rights attached to the shares were suspended under the terms of the scheme in order to avoid the application of the Code. The Code has no anti-avoidance mechanism to address this behaviour.

29. The Panel may grant an exemption from the Code's requirements in relation to the elements of an amalgamation or scheme which may be captured by the Code and in respect of which an exception under rule 7 of the Code is not available. A focus of concern for the Panel in granting such exemptions (which will be reflected in the conditions attached to the granting of the exemption) is to ensure that the information to be provided to shareholders, and the shareholder voting approval thresholds, mirror the requirements of the Code.

[3] Such changes of control will only have Code consequences if the amalgamated company becomes a Code company (i.e., it will be listed or will have 50 or more shareholders) and the manner in which the amalgamation is structured results in a person becoming the holder or controller of more than 20% of the voting rights in the amalgamated company.

Broader regulatory environment

30. An additional layer of regulation is also involved for companies listed on registered exchanges such as New Zealand Exchange Limited (NZX). Listed companies also have to comply with the Securities Markets Act's continuous disclosure requirements and the Securities Act's prospectus and investment statement disclosure requirements for offers of securities.

31. When listed companies are involved in takeovers, schemes or amalgamations, the NZX:

    (a) reviews meeting notices for schemes and amalgamations to ensure that shareholders have information in a readable and understandable form;
    (b) monitors the disclosures required to be made under the Listing Rules;
    (c) approves independent advisers to prepare appraisal reports, if required under the Listing Rules;
    (d) suspends trading in the stock five days after a compulsory acquisition notice has been sent to outstanding shareholders; and
    (e) deals with applications for waivers and with complaints of breaches of the Listing Rules.

32. In addition, the Securities Commission has an oversight role in respect of offer documents and market practices that might mislead securities markets participants.

<u>Nature of the problem</u>

33. In a change of control involving a Code company the bidder and some shareholders in, and the Board of, the target company can, and sometimes do, structure takeover bids so that the Code does not apply, using provisions in the Companies Act. This creates a situation of regulatory arbitrage, where the promoters of the reconstruction or transaction can pick and choose between the available regulatory regimes to improve their chances of success for the deal. While that appears on its face to be attractive in terms of achieving the efficient allocation of resources, it also creates uncertainty and may result in (or result in perceived) unfairness to investors.

34. There is a concern about how this might affect shareholders and the integrity and competitiveness of the New Zealand capital market.

35. The Panel regards market integrity as a situation where there are clear property rights, clear, fair and consistent rules about the protection and exchange of those rights, enforcement of the rights, predictable outcomes (e.g., in the case of a dispute), and transparency. In the corporate control context integrity is about protecting the legitimate interests of shareholders by ensuring that control of companies cannot change without the appropriate participation of shareholders.

36. Competitiveness in this context is the ability to freely change the control of ownership, which is helped by there being potentially many buyers and sellers

of shares, cost-effective mechanisms that facilitate the making and considering of offers, and good information available at reasonable cost.

37. When the Panel was formulating the Takeovers Code, it had to strike a balance between the competing objectives set out in section 20 of the Takeovers Act.[4] The rules of the Code provide procedures that regulate for fairness and the autonomy of shareholders' decision making, while also encouraging competition for control and the efficient allocation of resources.

38. The reconstruction provisions of the Companies Act were adopted from other jurisdictions' reconstruction statutes and were clearly not drafted with the New Zealand Takeovers Code's objectives in mind.[5]

39. In its 2007 discussion document the Panel defined the problem on the basis that although the outcome of a scheme or amalgamation can be the same as a successful full takeover that goes to compulsory acquisition, the requirements of the Code are expressly designed to be fairer, to provide equality of treatment and to give shareholders in the target company greater protection from the potential adverse consequences of a change in control:

(a) the shareholder approval thresholds for amalgamations and schemes are in effect lower than for Code offers;

(b) shares can be compulsorily acquired at a significantly lower approval threshold under an amalgamation or scheme than is provided in the Code;

(c) shareholders may receive lower quality information in respect of a proposed amalgamation or scheme than they would in respect of a Code offer;

(d) the Code provides for a longer time period to consider an offer, whereas, under an amalgamation or scheme, approval can be attained at a single meeting;

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[4] These objectives are set out below in the objectives section of this paper.

[5] A concise judicial discussion on the provenance of Parts 13, 14 and 15 of the Companies Act 1993 is found in the recent Court of Appeal decision in *Elders New Zealand v PGG Wrightson Limited* [2007] NZCA 596 (CA277/06) at paragraphs [18] to [20]:

"*The Part 15 procedure is broadly comparable to that provided under s 205 – 207 of the Companies Act 1955 which in turn can be traced back via the Companies Act 1933 to s 129 of the Companies Act 1929 (UK). That section was construed reasonably narrowly by the House of Lords in* Nokes v Doncaster Amalgamated Collieries Ltd *[1940] AC 1014; in particular as not permitting a transfer of contractual rights (in that case associated with a contract of employment) which were not otherwise assignable by the parties. Perhaps as a result of* Nokes, *Canadian legislatures adopted a rather different approach to amalgamations under which the relevant statutes provided that the amalgamating companies continued in the form of the amalgamated company. … When the Law Commission reported on the reform of New Zealand company law, it proposed what was in effect a Canadian rather than a United Kingdom approach. Its recommendations were for essentially what are now Parts 13 and 14, and contained nothing equivalent to Part 15. That Part was inserted as a result of the recommendations of the Justice and Law Reform Committee's report of 15 December 1992. As a consequence, Parts 13, 14 and 15 provide something of an awkward mix and match rather than a coherent regime.*"

(e) under the Code the consideration and terms of an offer to shareholders must be the same for all shareholders regardless of the size of the shareholding, but there are no such constraints in the case of an amalgamation or a scheme where there is no requirement for equal treatment of shareholders;

(f) the Code provides for a complaints vehicle (the Panel, which can intervene and resolve breaches) at a nil or a relatively low cost to aggrieved parties, whereas under the Companies Act complainants may face delays and significant legal and Court costs.

40. With the benefit of the submissions made on the 2007 discussion paper, and further consideration of the way other jurisdictions regulate schemes and takeovers, the Panel now believes that the problem can be defined a little more narrowly in respect of the fairness and protection concerns. This is because the Panel considers that with relatively minor regulatory change to improve the procedures and information for shareholders, the Court is the appropriate supervisor of schemes. It can ensure that a scheme is reasonable for shareholders to approve and that dissentient shareholders' concerns about a proposed scheme are suitably managed.

41. However, the problem in New Zealand is that the Court only hears from the promoters of a scheme and there is no external expert to assist the Court. Under our adversarial judicial system, the Judge (as in other common law jurisdictions) is only able to base his or her decision to approve the scheme on the information that is put to him or her. No one stands in the shoes of the shareholders who are to be bound by the scheme, to raise any issues of concern, or, conversely, to give assurances that from the shareholders' perspective there are no concerns, for the benefit of the Judge. There is no independent advocate to point out to the Judge whether the promoters of a scheme have different interests than the other shareholders, whether the information for shareholders is balanced or is slanted to promote the scheme, or whether the information fully explains what the value is to the promoters of having the scheme approved.

42. While, theoretically, a shareholder could present these issues to the Court, the reality is that the costs, complexity and technicality of the issues generally preclude all but the largest of shareholders from doing so, and, in fact, shareholders rarely make such appearances. Even when they do, it has usually, perhaps always, been an appearance at the final scheme hearing, after the scheme proposal has been put to shareholders for approval.[6]

43. In respect of Part 13 amalgamations, there is no Court supervision for giving consideration to, or managing, the impact of an amalgamation on the shareholders.

44. However, the use of the reconstruction provisions may create benefits for the offeror and for at least some of the shareholders of the target company:

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[6] This was the case in *Weatherston v Waltus Property Investments Limited* [2001] 2 NZLR 103 (CA), one of the few reported cases on a Part 15 scheme.

(a) greater certainty of outcome – one shareholder meeting determines the success or failure of the proposal, unless the proposal is conditional;

(b) potentially greater speed (although there have been instances of lengthy conditionality to proposed amalgamations that could see months pass before the outcome is known).

45. While the Panel accepts that schemes and amalgamations are appropriate and necessary vehicles for carrying out some types of company reconstructions and mergers (with proper safeguards for shareholders), the current situation of regulatory arbitrage and avoidance of the Code through deal structuring, is of concern.[7]

46. The Panel believes that this regulatory arbitrage may result in the following potential costs:

(a) undermining of the integrity of the market, resulting in fewer market participants than otherwise, which can adversely affect allocative efficiency and market liquidity;

(b) raising of the risk premium associated with investing in New Zealand, hence discounting share values;

(c) generating of inefficiencies, as companies spend resources on structuring transactions in such a way as to enable avoidance of the Code, rather than on productive activity;

(d) potentially lowering share prices, as reduced competition in friendly 'takeovers' essentially forecloses other offers;

(e) unequal consideration for some shareholders;

(f) a shortened timeframe for making decisions, or compulsory acquisitions at too low a threshold, so that some shareholders sell (under a compulsory process once the approval threshold is met) at a price that is lower than one at which they would have wished to sell.

47. While efficient economic outcomes for changing control of companies are important, the Panel puts particular emphasis on ensuring procedural fairness. The Panel regards the Code's procedures as prescribing a minimum standard, as is the case in Australia. It is therefore concerned that where alternative procedures are used and the Code's standards are not taken into account, they

[7] Several of the respondents to the Panel's 2007 discussion paper submitted that the status quo has created a situation of regulatory arbitrage. The NZX made the following comment: "*… the reputation of NZ's capital markets, already a marginal investment destination for off shore investors, will be adversely affected if the status quo were to remain. Any regulatory arbitrage in respect of such a key area of capital market regulation is undesirable from an integrity perspective. Liquidity would be impacted and accordingly pricing would also be affected. Where market participants are uncertain as to which particular takeover regime will govern their investment this will attract a risk premium. We believe these issues are significant in a marginal investment destination competing for global funds.*"

can give rise to an inferior process with potentially negative effects on shareholders' rights and on the integrity of the market in New Zealand.

OBJECTIVES

48. The objective of competition for changing corporate control, whether through Code takeovers, schemes of arrangement or amalgamations, is to maximise the returns on available resources, which improves the welfare of society. The Code and Parts 13 and 15 of the Companies Act provide for different mechanisms to effect changes in corporate control.

49. With this broad objective in mind, to determine whether the current regime or alternatives would be of net benefit to society, options are assessed against the objectives in section 20 of the Takeovers Act. The objectives of the Takeovers Act are set out below and highlight the sometimes competing goals of efficiency, and procedural and substantive fairness. All those making submissions on the Panel's 2007 discussion paper generally accepted that the section 20 objectives provide an appropriate benchmark against which to assess options for solving the problem.[8]

<u>Objectives of Takeovers Code</u>

50. Section 20 sets out the following objectives for a takeovers code:

    (a) Encouraging the efficient allocation of resources *(this objective requires an informed market with many buyers and sellers, clear property rights, and minimum barriers to trade)*;

    (b) Encouraging competition for the control of specified companies *(i.e., Code companies. This objective requires that there are no or low barriers to entry or exit and low transaction costs)*;

    (c) Assisting in ensuring that the holders of securities in a takeover are treated fairly *(this objective is interpreted as requiring equal opportunities to participate in a change of control; equivalent consideration for shares; appropriate shareholder support thresholds; and no compulsory taking of shares except for very good reason)*;

    (d) Promoting the international competitiveness of New Zealand's capital markets *(this objective requires reduced transaction costs and risk perceptions through encouraging confidence in the integrity of the New Zealand market)*;

    (e) Recognising that the holders of securities must ultimately decide for themselves the merits of a takeover offer *(this objective requires*

[8] However, a number of respondents argued that the status quo should remain (their major concern was that the ability to undertake schemes and amalgamations under the Companies Act should not be removed). These views are discussed more fully in the Consultation section of this paper.

individual shareholders having access to adequate information and being given sufficient time to consider a takeover offer);

(f) Maintaining a proper relation between the costs of compliance with the Code and the benefits resulting from its existence *(this objective requires knowledge of the costs and benefits).*

OPTIONS

<u>Option 1 – the Panel's Preferred Option – Court approval required for amalgamations and schemes of arrangement, with Panel input</u>

51. The Panel's preferred option (referred to hereafter as the preferred option) is that the Court is the supervisor of all amalgamations and schemes of arrangement involving Code companies, and the Panel provides input into those decisions where voting rights in a Code company are affected in any way by the scheme or amalgamation. The Panel's main role would be in providing a statement to the promoter of such a scheme or amalgamation, for producing to the Court, that the Panel has "no objection" to the proposed reconstruction.

52. The Panel will develop and publish information about the criteria it would apply for the giving of a "no-objection" statement. Although the policy development on these criteria is yet to be undertaken, they are expected to include the following:

- the information proposed to be given to shareholders must meet disclosure standards similar to those required by the Code (including an independent adviser's report prepared by an adviser approved by the Panel); and

- any interest classes amongst the shareholders must be satisfactorily identified in accordance with guidance on determining interest classes that will be included in Part 15 of the Companies Act (see paragraph 57, below) for the purposes of shareholders voting on the scheme.

53. The Panel will also publish guidance for the market on the timing of the giving of "no-objection" statements *vis-à-vis* the Court processes for schemes, on how to obtain a "no-objection" statement, and on any fees for making "no-objection" statement applications. Promoters of the scheme would be encouraged to liaise closely with the Panel over these issues before applying to the Court for initial orders for the scheme.

54. To achieve this, a provision in terms similar to section 411(17) of the Australian Corporations Act 2001 (Cth) would be inserted into Part 15 of the Companies Act.[9] This provision would prevent the Court from approving a

[9] Section 411(17) of the Australian Corporations Act 2001 (Cth) provides that:
(17) The Court must not approve a compromise or arrangement under this section unless:
(a) it is satisfied that the compromise or arrangement has not been proposed for the purpose of enabling any person to avoid the operation of any of the provisions of Chapter 6 [i.e., the takeover provisions]; or

scheme that would have any effect on the voting rights of a Code company unless:

- the Court is satisfied that the shareholders of any such Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code,[10] or

- there is produced to the Court a statement in writing by the Panel stating that the Panel has no objection to the scheme of arrangement.

However, the Court need not approve a scheme even though a statement by the Panel, stating that the Panel has no objection to the scheme, has been produced to the Court.

55. It is intended that the existing common law tests that are applied by the Court for approving a scheme would be preserved.[11] Accordingly, the new provision would create an additional threshold to be satisfied by the promoters of a scheme. This is in accord with how the provision works in Australia.[12]

56. The voting thresholds for the shareholder resolutions (as referred to in section 236(2)(b) of the Companies Act)[13] would be stipulated so that for the resolutions to be passed -

(a) Those voting in favour represent 75% of the votes cast on the resolution at each meeting of shareholders (see sub-paragraph (c));

(b) Those voting in favour represent a majority of the shares eligible to be voted (i.e., more than 50% of total voting rights of the company);

(b) there is produced to the Court a statement in writing by ASIC stating that ASIC has no objection to the compromise or arrangement;
but the Court need not approve a compromise or arrangement merely because a statement by ASIC stating that ASIC has no objection to the compromise or arrangement has been produced to the Court as mentioned in paragraph (b).

[10] The Panel proposes using some different wording to that used in section 411(17) of the Corporations Act, in order to ensure a proper fit for the New Zealand Code and for the local reconstructions context. For example, in relation to the Code, the focus is on 'voting rights', while in Australia the takeovers regime focuses on 'relevant interests'. In addition, despite the wording of section 411(17), ASIC has found that it is more relevant to weigh up the *outcome* of a proposed scheme, rather than the *purpose* of using the scheme process, when considering whether to give a no objection statement. Moreover, the New Zealand Panel wants to ensure that transactions such as simple capital reductions (for example the 2007 'Yellow Pages' capital return for Telecom Limited's shareholders) are not inadvertently caught by the proposed new requirements.

[11] See *CM Banks Limited* [1944] NZLR 248: the Court has a duty to ensure that:

(a) There has been compliance with the statutory provisions;
(b) The scheme has been fairly put before the class or classes of shareholders concerned;
(c) The class of shareholders is fairly represented by those who attended and that the statutory majority is acting bona fide; and
(d) The scheme is such that an intelligent and honest business person, a member of the class concerned and acting in respect of that interest, might reasonably approve.

[12] See, e.g., *Re Coles (No 2)* (2007) 65 ACSR 494.

[13] Section 236(2) of the Companies Act enables the Court to make initial orders relating to the scheme proposal that is to be put to the shareholders. Under section 236(2)(b) those orders can include directions from the Court on the holding of a meeting or meetings of shareholders *or any class of shareholders* to consider and, if thought fit, to approve the scheme proposal.

(c) The voting threshold in sub-paragraph (a) must be obtained at each meeting of each group of shareholders (as determined by the Court under section 236(2)(b) of the Companies Act as being an interest class for the purposes of voting on the resolution).[14]

57. Legislative guidance on the principles to be applied by the Court in determining which groups of shareholders constitute the interest classes in respect of which separate meetings should be ordered, would be included in Part 15 of the Companies Act. This would result in codifying the common law on interest groups at least to some extent.

58. For example, the common law principles include the following:

- a class will be determined by finding a different state of facts existing among different shareholders which may differently affect their minds and their judgement.[15]

- The Court must address whether the rights and entitlements of the different groups, viewed in the totality of the scheme's context, are so dissimilar as to make it impossible for them to consult together with a view to their common interest.[16]

- The classes are to be constituted depending upon the similarity or dissimilarity of the shareholders' rights against the company and the way in which those rights are affected by the scheme, and not upon the similarity or dissimilarity of their private interests arising from matters extraneous to such rights.[17]

- Where the scheme produces a takeover, clearly the offeror and its associates have different interests from the other target company shareholders and must vote at a separate meeting.[18]

- The question of whether separate class meetings are required depends not only upon the distinct features of one group of members as against another, but upon an analysis of the effect of those differences upon both the rights to be varied under the scheme, and the new rights given by the scheme to those whose rights were to be varied.[19]

59. The use of the Part 13 long form amalgamation, under section 221 of the Companies Act, would be prohibited where an amalgamating company was a

[14] Accordingly, the voting threshold is twofold: Not only must the resolution be supported by 75% of the votes cast at a meeting of each group of shareholders that constitutes an interest class, but also the votes so cast must, in total, represent more than 50% of the total voting rights of the company.
[15] *Sovereign Life Assurance Company Dodd* [1892] 2 QB 573, at 580.
[16] *Re HIH Casualty and General Insurance Limited Ors* (2006) 57 ACSR 791, at 808, quoting *Re Hills Motorway Limited* (2002) 43 ACSR 101, at 104.
[17] *UDL Argos Engineering & Heavy Industries Co Limited v Li Oi Lin* [2001] 3 HKLRD 634, as referred to in *HIH Casualty and General Insurance Limited*, at 809.
[18] *Re Archaean Gold NL* (1997) 23 ACSR 143, at 148.
[19] *Re Australian Co-operative Foods Limited* (2001) 38 ACSR 71 at 88.

Code company. However, short form amalgamations that relate only to wholly owned subsidiaries, under section 222, would still be available.

60. Where the Panel gave a no objection statement, any Code companies involved in the scheme would be exempted from the application of the Code.[20]

61. In order to ensure that the preferred option is effective and efficient in practice, it is hoped that a wide range of interested parties will participate fully during the Select Committee process, after the Bill is introduced into the House.

Option 2: Statutory exemption from Code

62. This option was to amend the Takeovers Act and the Code to exempt from the Code schemes and amalgamations involving a Code company. The Companies Act would also be amended so that the Panel was involved in the processes as described under Option 1 in the 2007 discussion paper.

63. The responsibilities of the Ministry of Economic Development (MED) and the Panel would be expanded to become proactive in investigating complaints about schemes and amalgamations in relation to compliance with the requirements of the Companies Act, particularly where Code companies are involved.

Why not the preferred option?

64. Option 2 is now partially incorporated into the preferred option, in relation to the proposed exemption from the application of the Code where the Panel gave a "no-objection" statement.

65. There is no need to increase MED's role if the Panel assumes the role, consistent with its expertise, that ASIC has in Australia under section 411(17) of the Corporations Act. Several of the submissions on the Panel's 2007 discussion paper suggested that MED's role should not be increased. Several of the submitters agreed that the Panel is the appropriate regulator where Code companies are involved.

Option 3: Align Companies Act's thresholds and disclosures with the Code

66. This option proposed amending the Companies Act so that:

(a) shareholder approval thresholds in respect of schemes and amalgamations are specified in the Companies Act and are consistent with the requirements of the Code, where Code companies are involved, for similar changes of control; and

[20] The preferred option is thus a combination of Options 1, 2 and 4 from the Panel's 2007 discussion paper with some additional modifications based on the submissions received and further research undertaken.

(b) any scheme or amalgamation proposal, involving the change of control of a Code company, must contain the same information as would be provided in respect of a Code offer with a similar outcome.

67. Option 3 had six sub-options. That is, the following three options could be with *or without* separate approval by ordinary resolution of non-interested shareholders.[21] All six sub-options would include a requirement that the scheme or amalgamation proposal provided to shareholders must contain the same information as would be provided in respect of a Code offer:

(a) an independent report for shareholders on the merits of the transaction, to be prepared by an independent adviser approved by the Panel;

(b) disclosure of key assumptions used in the valuation of any asset or prospective financial information about the target company;

(c) disclosure about which shareholders have already agreed to vote in favour of the proposal, the material terms of the agreement, and details of the ownership of equity securities in the amalgamating companies by the directors of the companies involved in the proposal and by all substantial security holders[22] of the companies involved in the proposal;

(d) disclosure about the persons involved in the formulation of the proposal, and their and their associates' ownership of voting securities in any of the companies involved in the proposal;

(e) for an amalgamation or scheme with the type of transaction described in sub-paragraph (b) under Option 3C below, a statement of the general nature of any material changes likely to be made to the business activities of the amalgamated company and its subsidiaries, if the proposal is approved by shareholders.

<u>Option 3A Approval level set at 50% of voting rights</u>

68. For the approval threshold to be universal, and consistent with the Code's requirement for control, an appropriate approval threshold could be a positive vote representing more than 50% of total voting rights of the target company.

<u>Option 3B Approval level set at 75% of voting rights</u>

69. Approval by Option 3A's 50% of total voting rights, for what is effectively a compulsory acquisition, might be considered too light, while a requirement for approval by 90% of total voting rights might be considered impossible to

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[21] "Interested shareholders" could be excluded from voting on a scheme or amalgamation, that is, the voting rights attached to shares held by parties associated with the formulation and promotion of the proposal could be excluded from the vote.

[22] I.e., those holding or controlling 5% or more of the shares.

achieve. Therefore, a median-ranged percentage, such as 75% of total voting rights, might be considered the most appropriate equivalence to the Code thresholds.

Option 3C Approval level set by type of takeover

70. If the approval thresholds were to be tailored to the particular type of transaction, and prescribed in law, the following gradations in approval levels might be appropriate (in conjunction with a special resolution of each company):

(a) for a full cash takeover, or where scrip is provided as consideration and the target company shareholders become very minor shareholders in the bidding company, by a 90% majority of total voting rights of the target company;

(b) for a merger of shareholders, where the participating companies' shareholders will end up with a control influence in the continuing company roughly proportionate (taking account of the dilutionary effects of the amalgamation) to their former position in the amalgamating companies, a 50% majority of total voting rights, for each of the companies involved in the proposal;

(c) for a reconstruction involving no or minimal change in effective control, no special voting requirements other than the usual special resolution.

Why not the preferred option?

71. The Panel felt that prescribing the information to be provided to shareholders in relation to a scheme or amalgamation would ensure that shareholders are provided with adequate information to decide for themselves the merits of the transaction.

72. However, while options 3B, and 3C could support the objective that holders of securities are treated fairly in takeovers, because of the potentially high shareholder voting thresholds, selecting the appropriate alternatives under Option 3C, especially in complex transactions, would involve value judgements, and thus some authoritative exercise of discretion to determine which category a proposal should fall into. A mechanism (such as the Court's discretion, the Panel's discretion, or some other body's discretion) would be required to fill this role. Given the number of variables, the complex array of transactions that can be undertaken under the Companies Act, and the level of uncertainty, none of the sub-options is preferred by the Panel. A few of the submissions on the Panel's discussion paper supported Option 3, but there was no overwhelming support for any one of the sub-options and concerns were expressed about the inherent uncertainty attached to them.

Option 4: Prohibit Part 13 amalgamations in respect of Code companies

73. Under this alternative it was proposed that the reconstruction provisions of the Companies Act would be amended so that amalgamations under Part 13 of the Companies Act cannot be undertaken at all if a Code company is involved. This would move the statutory regime in New Zealand closer to that in Australia, where amalgamations without Court supervision are not included in the Corporations Act. That is, in Australia, to achieve an amalgamation (as provided for in New Zealand in Part 13 of the Companies Act), it must be undertaken as a Court-approved scheme.

74. Option 4 would mean that, to achieve a change of control of a Code company, the mechanisms under the Code or the scheme mechanism under Part 15 of the Companies Act would have to be used.

Why not the preferred option?

75. Option 4 is now largely incorporated into the Panel's preferred option. Removing the availability of Part 13 of the Companies Act for Code companies would not prevent amalgamations being undertaken under Part 15 of the Companies Act by way of a scheme. The Court of Appeal has recently confirmed that an amalgamation undertaken under Part 15 achieves the same legal effect for the companies as one undertaken under Part 13.[23]

76. As a stand alone option, Option 4 is not optimal, because Part 15 does not contain the same protections as Part 13 has in the way of minority buy-out rights. Although Part 15 of the Companies Act provides some statutory protection for shareholders, under its current form there is no one to put the case for dissentient shareholders that they should not have to be bound by the scheme. Nor can the Court currently take the Code into account in deciding whether to approve the transaction. Removal of Part 13 of the Companies Act without further amendment to Part 15 would potentially disadvantage shareholders, thereby resulting in inconsistency with the objective of fair treatment of shareholders.

Option 5: Prohibit schemes and amalgamations in respect of Code companies

77. Option 5 proposed the amending of the reconstruction provisions of the Companies Act so that neither amalgamations nor schemes, under Parts 13 or 15 of the Companies Act, could be used where Code companies are involved, except with the permission of the Panel in circumstances where the use of the reconstruction provisions was clearly warranted.

78. It would mean that if bidders wished to achieve a change of control of a Code company they could only use the takeover mechanisms under the Code, unless otherwise permitted by the Panel.

[23] *Elders New Zealand Limited v PGG Wrightson Limited* [2007] NZCA 596 (CA277/06).

Why not the preferred option?

79. Option 5 envisages a complete ban on schemes and amalgamations under Parts 13 and 15 of the Companies Act unless the Panel permits their use. The Panel believes that a ban, subject to a Panel override of the ban, is heavy-handed and would put a heavy compliance burden on proponents of a scheme or amalgamation. The underlying premise of this option is that schemes and amalgamations are used to avoid the Code. The Panel accepts that this is not necessarily the case and that it can be commercially sensible to structure a transaction as a scheme or an amalgamation.

80. Although Option 5 was favoured by several of the respondents to the Panel's 2007 discussion paper (albeit in conjunction with elements of other options) some respondents were concerned at the level of discretion that would be left to the Panel, and that this would lead to uncertainty.

81. The Panel believes that it is not appropriate for it to be the arbiter of whether a transaction can be undertaken as a scheme or an amalgamation. The Panel believes that the arbiter of this question should be the Court (with the Panel's input).

Analysis of Preferred Option

<u>Advantages</u>

82. The preferred option (Court approval required for amalgamations and schemes, with Panel input) provides the flexibility advocated for by market participants of allowing the use of the Part 15 scheme of arrangement procedure. Section 238 of the Companies Act preserves the ability to undertake an amalgamation under Part 15, so the preferred option does not prevent amalgamations.[24]

83. The preferred option would resolve the concerns of several of the respondents to the Panel's 2007 discussion paper about the quality of information to be provided to shareholders under a Part 15 scheme of arrangement. The Panel's role would ensure that the information was balanced by including advice from an independent adviser approved by the Panel. In addition the Court would have the assistance of the Panel's input in a role akin to that of *amicus*, in those cases where the Panel decided to appear. The Panel would clearly have standing under section 236(2) of the Companies Act to appear and be heard, in view of its role with the "no-objection" statement.

84. If the Panel chose to not appear, the Court would have the assistance of the Panel's "no-objection" statement. However, as the final decision maker, the Court could decide to not approve a scheme even though the Panel had provided a "no-objection" statement. The normal appeals process would

[24] The Court of Appeal decision in *Elders New Zealand Limited v PGG Wrightson Limited* [2007] NZCA 596 (CA277/06), at paragraph [29] confirms that an amalgamation approved by the Court under Part 15 of the Companies Act has the consequences described in Part 13's section 219, that two or more companies may amalgamate and continue as one company.

provide an avenue for the scheme's promoters to have the merits of such a decision reviewed, if they believed it was wrong.

85. If promoters of a scheme that affected the voting rights in a Code company applied for the Court's approval of the scheme without obtaining a "no-objection" statement, the Panel would very likely oppose the application. The final decision-maker would still be the Court. It is conceivable that the Panel may oppose a scheme but the Court still approve it.

86. Providing guidance in the legislation on the voting thresholds to be met, and on determining the interest classes for voting on the resolution, would provide certainty for the market and clarity for the Court. Again, the Court would be assisted by the Panel's "no-objection" statement which would have been given on the basis of the Panel having been satisfied as to the manner in which the scheme promoters were to classify the voting interest groups for shareholders.

87. The evidence available to the Panel when preparing the 2007 discussion paper indicated that the vast majority of companies in New Zealand are not Code companies. The proposal, therefore, to ban the use of section 221 amalgamations where Code companies are involved would be of limited impact overall. It would not unduly adversely affect the companies that are Code companies because they could still amalgamate, with Court supervision under Part 15 of the Companies Act,[25] and it would have no impact at all on most New Zealand companies.

88. Once the Takeovers Code came into effect in 2001, the market accepted that a scheme may not be feasible without an exemption from the Panel if the fundamental rule of the Code would be triggered as a result of the scheme. The Panel considered three such exemptions in the four years leading up to the Sky/INL scheme of arrangement. In response to the Panel's regulation of the terms of the schemes that fell within the jurisdiction of the Code, scheme proponents, beginning with Sky/INL in 2005, structured transactions to have the Court suspend voting rights, thereby taking the scheme out of the Code's jurisdiction. The Panel understands from anecdotal evidence that Part 15 of the Companies Act has generally been used in preference to Part 13 for amalgamations in order to avoid the minority buy-out rights available under section 110 of the Companies Act for dissentient shareholders under a Part 13 amalgamation.

89. The Panel became involved in the Dominion Income Property Fund Limited (Dominion) scheme of arrangement, in October 2006, having issued two discussion documents earlier that year outlining its concerns with the Companies Act mechanisms being used as a way to avoid the Code. The Panel appeared in the High Court and Court of Appeal in the Dominion case, putting its views on the voting thresholds the Court should specify for the shareholders' approval of the scheme – all three companies involved in the scheme were

[25] The Panel notes that one of the law firms had submitted that by prohibiting Part 13 amalgamations for Code companies, the section 110 minority buy-out right, which guarantees a level of protection for dissentient minorities, would be removed. However, under the Panel's preferred option, the Panel, acting as amicus, could assist with ensuring that protections for dissentient minorities were made available.

Code companies. Thereafter, all significant transactions undertaken using the Companies Act reconstruction provisions, where the transaction was structured so that the Code would not apply, have been undertaken as Part 13 amalgamations.[26]

90. The Panel anticipates that, under the preferred option, the promoters of company takeovers and reconstructions would make their decision on the mechanism for undertaking changes of control based on the most efficient method of achieving the desired outcome, which may be a takeover or may be achieved as an arrangement or an amalgamation under Part 15 of the Companies Act, (having first obtained a "no-objection" statement from the Panel).

91. The preferred option would also align New Zealand's takeovers law more closely with that in Australia. While alignment with Australia was not one of the stated policy objectives, section 24 of the Takeovers Act does require the Minister to have regard, as far as practicable, to co-ordination of business law between Australia and New Zealand when recommending changes to the Takeovers Code.[27]

Disadvantages

92. The disadvantages of the preferred option fall mainly on prospective acquirers of control of Code companies. It raises the bar for these acquirers in the sense that they either would now need to comply with the requirements of the Code (involving the scrutiny and enforcement role of the Panel and achieving acceptances by 90% of the shareholders of the target company in order to compulsorily acquire any outstanding shares), or obtain a "no-objection" statement from the Panel to undertake a scheme under Part 15 of the Companies Act. The latter would mean increased interaction with the Panel and potentially payment of fees to the Panel if considering applications for the giving of a "no-objection" statement became a chargeable activity by the Panel.[28]

[26] The Panel notes that one law firm has submitted that removing the flexibility under the status quo would result in an increase in control transactions structured in other ways, e.g., liquidations or major transactions. While the Panel acknowledges that such an outcome is possible, the Panel is not aware of any evidence of an increase in the use of such transactions between 2001 when the Code came into effect and 2005 when the Sky/INL scheme was structured so that the Code would not apply to it.

[27] The Panel has noted one law firm's comments that the provisions of the Australian legislation in relation to takeovers does not take automatic precedence over the provisions of the Australian legislation that relate to schemes. The Panel accepts this. It is entirely consistent with the preferred option. The Panel also noted a submission by another law firm that ASIC has taken a "hands-off" approach to regulation by relying on the Court process set down in the legislation and that this has created an environment of confidence where schemes are used freely. However, the Panel's communications with ASIC and Australian practitioners make it very clear that ASIC takes a very "hands-on" approach in terms of market participants having to meet ASIC's requirements for the giving of "no-objection" statements for the use of schemes.

[28] In order to become a chargeable activity, an amendment would have to be made to section 8 of the Takeovers Act to include, as a function of the Panel, its role in relation to schemes. The Takeovers (Fees) Regulations 2001 would also need to be amended to accommodate the Panel's new role.

93. It is unlikely that there would be a significant increase in the costs associated with complying with the Panel's requirements for the information to be provided to shareholders, such as obtaining an independent adviser's report from an adviser approved by the Panel.[29] Currently, under a Part 15 scheme, the promoters of the scheme must provide all the information reasonably necessary to enable the recipients to judge and vote upon the proposal. This usually involves an adviser's report – however, currently, it is the promoters who alone determine whether to have a report prepared and determine who will prepare it. Unless shares or other securities are to be offered to the shareholders under the scheme, (in which case the Securities Act must be complied with, requiring registration of a prospectus and the preparation of an investment statement), it is the promoters of the scheme who alone determine the content of the information to be given to the shareholders.

94. While the Court's approval of a scheme must be obtained before the scheme can proceed, there is currently no advocate to draw to the Court's attention any shortcomings in the information for shareholders. It may be that the Panel's scrutiny of the information proposed to be provided to shareholders would result in additional costs to scheme promoters in ensuring the information disclosure is satisfactory to the Panel.

95. However, the information costs described above would be mitigated to the extent that a listed company would have structured the transaction as a Part 13 amalgamation, as it would then have been required by the Listing Rules to provide an independent appraisal report for the shareholders. In addition, the Code's disclosure rules are quite prescriptive. In that sense, they provide certainty. Under the Code, if the disclosure rules are complied with then the disclosure standard is automatically met. The current common law rules for disclosure in relation to a scheme are outcome based; all the information "reasonably necessary". If the Panel gives a "no-objection" statement for a scheme, the promoters and the Court might feel comfortable that the standard provided by the common law had been met. Certainty has its own value.

96. To the extent that the preferred option may increase the costs for promoters of undertaking a scheme, the preferred option may have a negative impact on the efficient allocation of resources.

97. A further potential disadvantage for acquirers under the preferred option is that it increases the third party oversight of transactions involving Code companies. The purely statutory amalgamation process under section 221 of Part 13 of the Companies Act (which involves little in the way of regulatory oversight) would no longer be available. In addition, for a scheme under Part 15 of the Companies Act, there would be not only Court supervision but also interaction

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[29] Many adviser applications are approved by the Panel for under, or around, $1000. However, the cost can be as much as around $5000 - $6,000 if the application involves difficult issues relating to potential conflicts of interest, requiring multiple inquiries by the Panel to resolve, or where the applicant seeks a reconsideration of a Panel decision to turn down an application. Generally, the cost of an adviser approval by the Panel equates to a very small percentage of the cost to the bidder of obtaining an independent adviser's report under the Code.

with the Panel which would scrutinise the information proposed to be provided to shareholders.

98. Accordingly, to the extent that the preferred option would raise the barriers for undertaking takeovers and reconstructions outside of the Code, the preferred option may have a negative impact on the competition for control of Code companies.

99. However, the preferred option would result in increased protections for shareholders, which the Panel views as improving the fair treatment of shareholders and increasing shareholder autonomy (the latter being a principle that subsists in the objective that holders of securities must ultimately decide for themselves the merits of a takeover offer). The Panel believes that these outcomes would also encourage confidence in the integrity of the New Zealand market for potential investors. The Panel views these outcomes as outweighing any disadvantages that may arise from an increase in costs and barriers for the use of the Companies Act reconstruction provisions.

100. Notwithstanding the higher hurdles to be negotiated by acquirers under the preferred option, an acquirer still could achieve 100% ownership of a Code company through a Part 15 scheme without having to reach the Code's 90% compulsory acquisition threshold. All of the commercial benefits to the promoters of schemes and amalgamations would still be available under the preferred option. Although the more than 50% of total voting rights threshold appears quite low (to those who believe that 90% should have to be achieved to require all shareholders to be bound by a scheme), the requirement of voting in interest classes would ensure that a majority of shareholders with no "interest" in the scheme proposal voted to approve the scheme.

101. The respondents who favoured the status quo argued that it is too difficult to shake shareholders from their apathy to make the more than 50% of total voting rights threshold achievable. However, it is questionable whether low shareholder voting turn out is rightly labelled as 'apathy'. For example, low voter turn out may be due to factors such as low quality, insipid or confusing information that fails to convey the significance of the proposal for the average retail investor.

102. Two very recent transactions demonstrate that assumptions about shareholder apathy are not universally correct: the recent Canada Pension Plan Investment Board (CPPIB) partial takeover offer for Auckland International Airport Limited (AIAL) achieved a voter turn out representing greater than 80% of AIAL's total voting rights. The Dominion scheme also achieved support by more than 50% of total voting rights of each of the three Code companies involved in the scheme. Although voter turn out of less than 50% is not uncommon for voting on a scheme or amalgamation, these recent cases show that high shareholder participation can be achieved when promoters are committed to galvanising shareholder participation.

103. While it is accepted by the Panel that the preferred option may result in an increase in the costs of utilising the Companies Act reconstruction provisions,

the main concern of respondents was, generally, not cost but to ensure that the flexibility of the use of the reconstruction provisions was not removed from the market. The preferred option achieves that by preserving the ability to undertake a scheme of arrangement, or an amalgamation by way of a scheme, under Part 15 of the Companies Act.

104. The preferred option would likely require additional funding for the Panel to give it the resources necessary to undertake the tasks envisaged, including the developing of policies and procedures in the initial set up phase. The Panel already has access to the use of its Litigation Fund for appearing in Court for schemes and does not envisage the need, at this point, for the Litigation Fund itself to be increased.

CONSULTATION

105. The Panel published its discussion document on 5 December 2007. Submissions closed on the 15th February 2008. The Panel received 16 submissions in all. Seven of these were from major law firms in New Zealand that offer advice on takeover activity. Three submissions were received from investment advisers/financial services providers; one was from an investment banker, and one from a valuer that undertakes independent adviser reports under the Takeovers Code and NZX Listing Rules. Submissions were also received from an individual investor, the New Zealand Shareholders Association, NZX and the New Zealand Law Society (NZLS).

Problem definition

106. In answer to the questions in the discussion document relating to whether there is a problem that requires fixing, approximately half the respondents agreed there is a problem while the other half, including six of the seven law firms, disagreed that there is a problem.

107. Approximately one third of the respondents suggested that the use of the Companies Act reconstruction provisions to effect changes of control of Code companies is likely to become more frequent under the status quo. One third disagreed that they would become more frequent and of these, three of the six law firms that preferred the status quo were represented. The other third of respondents, including the other three law firms that preferred the status quo to be maintained, did not comment on this question.

108. Just over a third of the respondents believed that the consequences for shareholders and for market integrity of the use of the reconstruction provisions where Code companies are involved were negatively significant. Just under one third (including three of the six law firms that preferred the status quo to be maintained) believed there were no negative or significant consequences from maintaining the status quo. One of those three law firms believed there were significant positive consequences from maintaining the status quo, in terms of

the certainty for the market both nationally and internationally available under the reconstruction provisions of the Companies Act.[30]

109. Four of the 16 respondents suggested that the information disclosed to shareholders under the three regimes was materially different, with the Code providing better information for shareholders. One of these (the independent adviser) commented that when, under a scheme or amalgamation, a report is provided for shareholders, the lack of prescribed rules about the report creates scope for influence to be exerted on the adviser, by the promoters, as to the content of the report. Six of the 16 respondents submitted that, in practice, there was no material difference between the level of information provided to shareholders under the various regimes. The others provided no comment.

110. Eleven of the respondents commented on the question of whether the rights and protections of the Code should apply to all changes of control of Code companies. Three of those respondents completely agreed with that proposal. Two respondents favoured shoring up the reconstruction provisions of the Companies Act with Takeovers Code rights and protections. They focused on the information to be given to shareholders under schemes and amalgamations and one of those two respondents also suggested that the Code's rules should apply to schemes and amalgamations in relation to voting thresholds and voting restrictions, and in respect of compulsory acquisition levels (i.e. 90% acceptance, as under the Code). Five of the six respondents who disagreed that the rights and protections of the Code should apply to all changes of control involving Code companies were adamant that the status quo should be maintained, while one of these six respondents preferred that the rights and protections of the Code be applied where the reconstruction provisions were used to undertake what is clearly a takeover (the example was given of the Waste Management takeover by TransPacific).

Policy objectives

111. All of the respondents either generally agreed with the policy objectives used in the discussion document or made no comment on them (ten clearly indicated that the objectives were appropriate). In relation to the question asking whether other objectives should be included for assessing the options, respondents largely made no comment or indicated that no other objectives were necessary. However, three of the respondents suggested additional policy considerations that could be applied, including the following: freedom of contract, integrity of company governance, avoiding the rewarding of shareholder apathy towards voting, flexibility for the mechanisms available for undertaking changes of control of companies, and shareholder information.

[30] What is meant by "certainty" in this context is that the promoter of the scheme or amalgamation knows whether the proposal will succeed as soon as shareholders have voted at the meetings to consider the proposal. However, a takeover must remain open for acceptance for a minimum of 30 days and may be extended to 90 days. In some circumstances a takeover in New Zealand may remain open for about five months.

112. In response to the question asking whether some objectives are more important than others, respondents generally made no comments. However, three submitters ranked allocative efficiency and promoting competition for control of Code companies in either first or second place for importance. One of those three respondents ranked international competitiveness as the second most important objective and two of the three ranked fair treatment of shareholders as the third most important objective.

Options

113. In response to the question as to whether there were any other options the Panel should consider, seven of the respondents made no significant comments. One respondent said no other options needed to be considered. Five of the respondents preferred that the status quo be maintained (three of these were law firms, one an investment banker and one an investment adviser), and one of these respondents suggested including legislative guidance on the class interest provisions where shareholders vote under the Companies Act.

114. One respondent suggested aligning the Companies Act information requirements with those of the Takeovers Code and also suggested that there be a dedicated regulator to provide oversight of changes of control occurring under the Companies Act. One of the respondents suggested that a modified version of Option 5 should be considered, under which the Panel would have to give its approval for a scheme or amalgamation to be undertaken where a Code company was involved, requiring the same information standard as for a takeover and setting out in the Code the process for the giving of the Panel's approval.

115. One of the law firm respondents suggested that the Court's jurisdiction for approving schemes of arrangement under Part 15 of the Companies Act could be elaborated to require approval thresholds by a stated majority of disinterested shareholders and confirming that arrangements for dissentient shareholders include minority buy-out provisions similar to those available under Part 13 of the Companies Act. The Court would set what the appropriate threshold would be for approval, under the circumstances. This respondent also suggested that there was no empirical evidence that the Courts have made the wrong decision to date in approving a scheme.[31]

116. In response to the question as to whether the respondents agreed with the Panel's assessment of the impact of the options, four respondents clearly disagreed with the Panel's assessment and argued that the status quo should be

[31] However, an article in the New Zealand Business Law Quarterly, volume 12, March 2006, *Schemes of arrangement under Part XV of the Companies Act 1993* by Sacha Oudyn, then a tax Manager at PriceWaterhouseCoopers, suggests otherwise. Mr Oudyn argues that the scheme of arrangement provisions are used to circumvent the minority buy-out rights available under Part 13 of the Companies Act for dissentient shareholders and that the Court of Appeal, in *Weatherston v Waltus Property Investments Limited* [2001] 2 NZLR 103, appeared to indicate that, had the circumstances been different – by the time the proceedings made it to the Court of Appeal, the scheme had already largely been implemented – a buy-out option for dissentient shareholders might have been required.

maintained. Five of the respondents partially agreed with the Panel's assessment. One of those, however, also suggested that the status quo should be maintained. Another suggested that MED's responsibilities should not be expanded, and, when considering imposing restrictions on voting rights, the requirement to vote in interest classes should be given greater attention rather than disenfranchising certain shareholders. Several respondents also indicated that, particularly if Option 1 in the discussion paper were chosen, clearly identifying interest classes would be necessary. One of these respondents (NZX) also suggested avoiding multiple regulators, and preferred the ability for the Panel to provide a no objection statement as proposed under Option 1.

117. An investment adviser, which was also in partial agreement with the Panel's assessment of the impact of the options, suggested that if Option 1 were chosen there should not be an additional requirement for approval by more than 50% of the total voting rights of the Code company. The concern was that of shareholder apathy.

118. Two respondents clearly agreed with the Panel's assessment. However, one of these, a law firm, reiterated that the status quo should be maintained. Four respondents gave no comment on this question.

119. In response to the question regarding which option was preferred, one respondent made no comment. Of the other 15 respondents, many indicated a "preference" for more than one option and it is not possible to highlight any one of the options as having anything like overall agreement.

120. Of these 15 respondents, seven suggested that the status quo should be maintained. Four of these were law firms, one an investment banker and two investment advisers. Of the investment advisers, one appeared to agree with any of the options but Option 2.

121. Option 1 received no outright acceptance by any respondents; however, two of the respondents suggested a combination of features from Option 1 and Option 5. Three respondents (apart from the two just mentioned) suggested Option 1 as a preferred option but also listed several other possible options as being preferred.

122. Option 2 received no agreement from any of the respondents. Two respondents preferred Option 4. Of the eight respondents indicating that Option 5 would be preferred, two have already been noted above in respect of preferring a combination of Option 5 and Option 1, one respondent, the New Zealand Shareholders Association, preferred a modified version of Option 5, and three respondents suggested Option 5 was preferred but also included several other possible options as preferences.

123. In relation to Option 3, six respondents in total indicated a preference for one of the sub-options of Option 3: the NZLS and one law firm preferred Option 3A, three respondents suggested Option 3B (but these also proposed several other possible options), and two respondents preferred Option 3C (again, suggested along with several other possible options). Of the six respondents who

indicated a preference for any of the sub-options of Option 3, two of those agreed that a separate vote of more than 50% of non-interested shareholders should be required, one indicated that a separate vote of non-interested shareholders should not be required, and three made no comment on that aspect of Option 3.

124. Those of the respondents who indicated a concern about requiring, under Option 1 or Option 3A, approval of a scheme or an amalgamation by more than 50% of total voting rights, or, under Option 3B, by more than 75% of the total voting rights, were largely concerned that it is too difficult (if not impossible) to achieve a sufficient level of shareholder voting to make such voting thresholds reachable. Some cited the Dominion scheme where the Court of Appeal overruled the Panel's submission that Dominion be required to achieve a shareholder approval threshold of more than 50% of the voting rights in the relevant Code companies.[32] The Panel believes that "shareholder apathy" can to some extent, even to a large extent, be overcome by sufficient encouragement to shareholders by the promoters of a scheme to vote on the proposal. In addition, the Panel believes that shareholders are more likely to have the confidence to vote one way or the other on a scheme proposal if they have adequate information that helps them to understand the merits of the proposal.

125. Two of the law firms which submitted that the status quo should be maintained, referred to their agreement with an article by Scott Clune, *Amalgamations, schemes of arrangement and takeovers regulations; concerns of the Takeovers Panel and the need for reform*, Canterbury Law Review [Vol 13, 2007] 91. In that article, Clune argues that the Panel's original proposals for schemes and amalgamations (as recommended to the Minister of Commerce and the Commerce Select Committee in 2006) were undesirable. The focus in those proposals of applying the "principles of the Code", at the Panel's discretion, are criticised in the article (and two of the respondents to the Panel's 2007 discussion paper refer the Panel to the concerns they had expressed in 2006 (without repeating them) about those aspects of the Panel's original proposals).

126. Since the focus of both of those respondents was that the status quo should be maintained, it appears that they may have overlooked the conclusion of the Clune article. Scott Clune suggests that the current New Zealand law is anomalous with that of a number of overseas jurisdictions and that a provision similar to section 411(17) of the Australian Corporations Act should be inserted into Part 15 of the New Zealand Companies Act. This is exactly what the Panel proposed in the 2007 discussion document as Option 1, which the Panel has now decided (with some modifications) is the preferred option.[33]

[32] However, in fact, the promoters of the Dominion scheme assured the Court that they would do their best to ensure that shareholders were encouraged to vote, and the scheme was approved by shareholders representing more than 50% of the total voting rights of each of the companies. Also, the recent partial takeover offer by the CPPIB for AIAL received votes approving of the partial offer by more than 60% of the total voting rights of AIAL, and the total turn out on the vote was greater than 80%.

[33] Clune argues, at page 120 of the article, that Part 13 amalgamations should be allowed to continue. Clune states that banning them would "represent a departure from the theoretical basis" of the Companies Act, resulting in a takeovers regulation system peculiar to the common law world. However, this overlooks the fact that by far the vast majority of companies in New Zealand are not Code companies and

Compulsory Acquisition

127. In response to the question as to whether the Code's 90% compulsory acquisition threshold contributes to the use of the Companies Act reconstruction provisions (in other words, whether it creates an incentive for bidders to avoid the Code), four respondents agreed that it did, five respondents suggested that it sometimes did or that it may do, five respondents made no comment and two respondents commented by reiterating the importance of the availability of the Companies Act reconstruction provisions.

128. There was no real interest from respondents on the questions related to reducing the Code's compulsory acquisition threshold. In relation to the question regarding to what level, if the compulsory acquisition threshold were reduced, it should be reduced, only four of the 16 submitters made any suggestions. These suggestions proposed thresholds ranging from 85% down to 75%. Of those who suggested 75%, the suggestion was also made that this threshold should represent 75% of non-interested shareholders or 75% of all shareholders if the Board had recommended the takeover.

Cost of Compliance

129. In response to the question regarding the advisers' fees paid by the parties to a Code offer, an amalgamation or a scheme, eleven respondents provided no comment. Four respondents indicated that the costs are related solely to the complexity of the transaction rather than the mechanism under which a transaction is achieved. One respondent (a valuer that undertakes independent adviser work) provided figures for the fees paid to it for such transactions, but requested that the figures not be released due to commercial sensitivity. However, that valuer also stated that the costs involved are related to the complexity of the transaction rather than the mechanism under which the transaction is undertaken. The figures provided show that a very complex transaction would result in fees of more than three times the amount of a straight forward transaction.

130. Submitters showed no real interest in commenting on the question regarding whether use of the different mechanisms imposed different time costs on staff, management and the Boards of the companies involved.

131. The Panel deduces from these reactions that compliance costs are not considered to have much significance in the context of transactions worth tens of millions to hundreds of millions of dollars. Clearly, the issue of greatest value to the respondents who represent "bidder" interests is certainty of outcome for a takeover or reconstruction.

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would still have the Part 13 amalgamation process available to them under the preferred option. The preferred option also maintains the availability of section 222 short form amalgamations for Code companies. Accordingly the preferred option would have no impact where Code companies simply wanted to reorganise their wholly owned subsidiaries. In any event, as several respondents note in their submissions, Australia does not have Part 13 type amalgamations available at all.

Other Comments

132. The Panel is grateful for the significant effort undertaken by respondents in their submissions. Many respondents reiterated again and again the importance that schemes of arrangement under Part 15 of the Companies Act remain available as a mechanism for complex transactions involving Code companies. Of those who preferred the status quo to any change, several suggested that more focus be given to shareholders voting in interest groups as occurs in Australia.[34] One commentator suggested that the lack of a dedicated regulator for schemes and amalgamations was indicative of a problem with the entire Companies Act regime, suggesting that the Companies Act have its own dedicated regulator for all transactions occurring under that Act.

133. In relation to the comments provided on voting in interest groups, respondents noted the importance of not disenfranchising those who are "interested" in a transaction, such as the promoters of a scheme – they should at least be able to vote against the proposal. In addition, some suggested that a person should not be considered "interested" merely because they had been associated with the formation of the proposal.

RECOMMENDATIONS TO THE MINISTER

134. In accordance with section 8(1)(a) of the Takeovers Act 1993, and having considered the submissions received on the 2007 discussion paper, the Panel recommended to the Minister of Commerce on 16 May 2008, that the following changes be made to the Companies Act 1993:

    (a) A provision is inserted into Part 15, under which the Court would be prevented from approving a scheme that would have any effect on the voting rights of a Code company unless:

    - the Court is satisfied that the shareholders of any such Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code, or

    - there is produced to the Court a statement in writing by the Panel stating that the Panel has no objection to the amalgamation or arrangement.

    However, the Court need not approve a scheme even though a statement by the Panel, stating that the Panel has no objection to the scheme, has been produced to the Court;

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[34] There appears to be little case law in New Zealand relating to the Companies Act 1993 in respect of the need to hold separate meetings for different interest classes (but there is ample case law in that regard under the Companies Act 1955). The 2007 *Elders v PGG Wrightson* case simply refers to the issue, at paragraph [49]. The Panel believes that the common law has developed in a robust fashion in Australia where much attention is given to the issue of voting in classes of shareholders to whom a scheme is put. In order to assist with the desire for clarity and certainty in implementing the preferred option, the Panel suggests codifying, to a certain extent at least, the common law as it has developed in Australia regarding voting in classes of shareholder interests.

(b) Voting thresholds, for the shareholder resolutions to approve of the scheme are stipulated, so that for the resolution to be passed –

(i) Those voting in favour represent 75% of the votes cast on the resolution at each meeting of shareholders (see sub-paragraph (c)); and

(ii) Those voting in favour represent a majority of the shares eligible to be voted (i.e., more than 50% of total voting rights of the company);

(c) The voting threshold in sub-paragraph (i) must be obtained at each meeting of each group of shareholders (as determined by the Court under section 236(2)(b)of the Companies Act as being an interest class for the purposes of voting on the resolution);

(d) Guidance for the Court should be included in Part 15 of the Companies Act on how to determine interest classes, for example by codifying (to some extent) the principles of the common law for determining those classes;

(e) The use of the Companies Act's Part 13 long form amalgamation, under section 221, should be prohibited where an amalgamating company is a Code company, but the availability of the short form amalgamation under section 222 should be preserved for all companies.

135. The Panel also recommended that the Takeovers Act and the Code should be amended:

(a) to provide a statutory exemption from the application of the Code where Code companies are involved in a scheme of arrangement under Part 15 of the Companies Act if the Panel has provided a 'no objection' statement for production to the Court; and

(b) as appropriate, and consequential to the proposed amendments to Companies Act, in order to ensure that the Panel has all the necessary statutory functions and powers to undertake the role proposed in these recommendations.