Ref: 700-100 / #82129

SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE COMPANIES

RECOMMENDATIONS TO THE MINISTER OF COMMERCE

Takeovers Panel
Level 8, Unisys House
56 The Terrace,
P O Box 1171,
WELLINGTON

Ph: (04) 471 4618
Fax: (04) 471 4619
Email: takeovers.panel@takeovers.govt.nz

25 August 2006

CONTENTS

INTRODUCTION

1. As part of its function of keeping the law relating to takeovers of specified companies (code companies) under review the Takeovers Panel is recommending to the Minister of Commerce changes to the Takeovers Code and the Companies Act 1993 regarding amalgamations and schemes of arrangement involving code companies.

2. The Code provides special rights and protections to shareholders of code companies in respect of transactions resulting in a change of control of the voting rights in that company. These protections include shareholder approval thresholds that must be met, compulsory acquisition rights and the requirement that shareholders be provided with information to enable them to decide the merits of a proposed transaction.

3. However, recently some market participants have avoided these shareholder rights and protections by structuring a merger involving a code company as a scheme of arrangement or an amalgamation so as to avoid the Code. There has been significant media and market attention on the ability to use the reconstruction provisions of the Companies Act in this way.

4. The Panel, like many market participants, is concerned that the rights of shareholders of code companies, particularly minority shareholders, in respect of mergers and acquisitions have become dependent upon the choice of mechanism used by parties to effect such a transaction.

5. The Panel considers that there should be consistency as to the rights and protections for code company shareholders regardless of the procedure used to effect a merger with or acquisition of a code company. It is the intention of the Code to provide protections to all code company shareholders in respect of transactions involving changes of control.

6. The Panel also considers that it is important to preserve the rights of companies to choose which means of changing control they wish to use.

7. The Panel recommends to the Minister that fulfilling the intention of the Takeovers Act while preserving the rights of companies to use different reconstruction mechanisms can best be achieved by amending the Code and Companies Act so that:

   - Schemes of arrangement and amalgamations are carved out of the Code completely; and instead

   - The principles of the Code are introduced into the provisions of the Companies Act dealing with schemes of arrangement and amalgamations.

8. The Panel recommends to the Minister that:

(a) the Code be amended to no longer apply to changes of control resulting from an amalgamation under Part XIII of the Companies Act or a scheme of arrangement under Part XV of the Companies Act; and

(b) Part XIII of the Companies Act be amended to require that:

(i) parties to a proposed amalgamation must obtain the approval of the Panel to the amalgamation process; and

(ii) the Panel, in giving approval for an amalgamation process, shall take into account the principles of the Code; and

(c) Part XV of the Companies Act be amended to require that:

(i) the Courts take into account the principles of the Code when deciding the requirements for approval of a scheme of arrangement, including the level of shareholder approval and the information to be provided to shareholders; and

(ii) before approving a scheme of arrangement the Court receives and takes into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved.

9. The Panel has reached these recommendations after considering; media and market comments; its own experience; and submissions made to the Panel in response to two recent Panel discussion papers regarding schemes and amalgamations involving code companies.

10. The matters which the Panel considered in deciding to make these recommendations are set out in this paper.

11. In this paper we discuss:

- the current provisions of the Code, Part XIII of the Companies Act in respect of amalgamations and Part XV of the Companies Act in respect of schemes of arrangement;
- the relationship between the Code and reconstructions under the Companies Act and the effect of the ability to choose different mechanisms to acquire a code company;
- the Panel's concerns regarding the use of schemes and amalgamations involving code companies;
- consultation carried out by the Panel:
    - the Panel's paper on exemptions for schemes of arrangement,
    - the Panel's discussion paper on schemes and amalgamations involving code companies.

THE CODE

12. The Code was introduced to protect the interests of all shareholders in respect of changes of control of publicly traded and other significant companies.

13. Prior to the introduction of the Code effective control of publicly traded companies could be passed without the participation of the majority of shareholders. Control could pass by the sale of the shares of a large shareholder without the involvement of remaining shareholders. The Code ensures that all shareholders in publicly traded companies have equal treatment and participation in takeover situations and as a result encourages greater confidence among investors.

14. The Code was also intended to encourage greater confidence in the integrity of the New Zealand market for international investors.

15. The Code governs changes of control of "code companies" which are defined as companies incorporated under the Companies Act which:

- are a party to a listing agreement with the New Zealand Exchange Limited (or were a party to a listing agreement in the previous 12 months); or

- have 50 or more shareholders and $20 million or more of assets.

16. Rule 6 of the Code, referred to as the fundamental rule of the Code, prohibits any person from becoming the holder or controller of more than 20% of the voting rights in a code company except by utilising one of the mechanisms set out in rule 7 of the Code. The main mechanism under rule 7 which can be used to acquire a code company shares is a takeover offer. There are also provisions permitting increases in the level of voting rights by the acquisition or allotment of voting securities with the approval of disinterested shareholders of the code company.

17. The purpose of the fundamental rule and the mechanisms contained in rule 7 is to ensure that if there is to be a change in the control of the code company, all shareholders have the opportunity to participate in the process.

18. In order for an offer, acquisition or allotment of shares which would otherwise be in breach of rule 6 to proceed the change of control must have the support of a specified level of shareholders of the code company as follows:

- A full takeover offer must be conditional on the offeror achieving control of more than 50% of the voting rights in the code company.

- An acquisition or allotment must be approved by a resolution of more than 50% of the shareholders of the code company who are entitled to vote and who vote on the relevant resolution at a meeting of shareholders[1]. Parties involved in the acquisition or allotment and their associates cannot participate in the vote[2].

[1] See rule 7(c) and 7(d) of the Code.
[2] See rule 17 of the Code.

19. The Code requires that in respect of any proposed change of control shareholders of the code company are provided with a document which provides them with information to enable them to decide for themselves the merits of an offer, acquisition or allotment. In respect of a takeover offer shareholders receive an offer document from the offeror and a target company statement from the target company. In respect of an acquisition or allotment of shares, code company shareholders receive a notice of meeting prepared by the target company. Both target company statements and notices of meeting are required to contain or be accompanied by a recommendation on the offer or proposed transaction from the directors of the target company and a report from an independent adviser on the merits of the offer or proposed transaction.

20. Securities in the code company cannot be compulsorily acquired unless a person[3] becomes the holder or controller of at least 90% of the voting rights in the code company[4]. The compulsory acquisition provisions of the Code allow a person who has reached the 90% threshold to squeeze out the minorities and gives the minorities the right to require the purchase of their shares. The compulsory acquisition threshold serves to establish a level which must be reached before shareholders can be compelled to sell their shares.

21. The provisions of the Code are intended to provide shareholders of a code company with special rights and protections in respect of their shareholdings. Common to all code transactions (whether code offers, acquisitions or allotments) the Code requires that:

- Shareholders are all treated equally and have the opportunity to participate in any change of control. The transaction cannot proceed without the support of a specified level of shareholders;

- Shareholders have sufficient information, including an independent adviser's report, to enable them to consider the merits of the proposed transaction;

- Securities in the code company cannot be compulsorily acquired until a person[5] becomes the holder or controller of 90% of the voting rights in the code company.

22. The Code is intended to provide these rights and protections for code company shareholders regardless of the mechanism utilised to effect a change of control.

23. By contrast, the scheme of arrangement and amalgamation mechanisms provided under the Companies Act do not provide the same rights and protections for code company shareholders. However, they can be utilised to effect a merger or acquisition involving a change of control of a code company.

24. We set out briefly below the provisions of the Companies Act relating to amalgamations and schemes of arrangement and outline the relationship of these provisions with the Code.

---

[3] Or two or more persons acting jointly or in concert

[4] The corollary of this requirement is that a person holding more than 10% of the shares of the code company can block the compulsory acquisition provisions.

[5] Or two or more persons acting jointly or in concert

AMALGAMATIONS UNDER PART XIII OF THE COMPANIES ACT

25. Under Part XIII of the Companies Act two or more companies may amalgamate and continue as one company, which may be one of the amalgamating companies or a new company, if:

    (a) the amalgamation proposal is approved by shareholders representing 75% of the voting rights voted at a meeting of shareholders of each amalgamating company[6]; and

    (b) the board of each amalgamating company resolves that in its opinion the amalgamation is in the best interests of the company and it is satisfied on reasonable grounds that the amalgamated company will satisfy the solvency test contained in the Companies Act[7].

26. Amalgamations under Part XIII are not limited to situations where two or more companies merge and the shareholders of the merging companies continue as shareholders of the amalgamated entity. The amalgamation provisions also anticipate amalgamations where the two companies amalgamate but the shareholders of one entity receive cash consideration from the other entity or have a cash alternative for their shares in an amalgamating company[8].

27. Neither the Code nor the Companies Act excludes the provisions of the Code to changes of control of code companies resulting from an amalgamation under Part XIII of the Companies Act.

28. Accordingly, if an amalgamation results in a person becoming the holder or controller of voting rights in a code company the fundamental rule will apply and the parties will need to consider whether they can utilise one of the mechanisms in rule 7 of the Code. Some amalgamations which involve the allotment or acquisition of shares by a person can be approved by shareholders in accordance with rule 7(c) or 7(d)[9].

29. However, amalgamations can be structured to avoid the Code.

30. If two companies are amalgamated and one is a code company the amalgamation can be structured so that the code company will be extinguished as a legal entity and the shareholders will become holders of shares in an entity that is not a code company. In these circumstances at no stage in the amalgamation process will any person actually obtain or control shares in the code company. Accordingly, even though such

[6] sections 221(5) and 106 of the Companies Act

[7] section 221(1) of the Companies Act.

[8] Section 220(1) of the Companies Act states that an amalgamation proposal must set out the terms of an amalgamation and specified matters in particular, including "if shares of an amalgamating company are not to be converted into shares of the amalgamated company, the consideration that the holders of those shares are to receive instead of shares of the amalgamated company".

[9] This was the case in a merger transaction undertaken by Wakefield Health Limited and Royston Hospital Limited in 2005. An allotment was to be made by one of the merging companies, a code company, to a major shareholder of the other company. The parties sought the approval of non-associated shareholders of the allotting company to the allotment under rule 7(d) of the Code.

amalgamation transactions may have the same ultimate result as a takeover offer under the Code they will not have any Code consequences. Parties merging with a code company in this way will not need to comply with the requirements of the Code.

31. An example of an amalgamation structured in this manner was the recent amalgamation of Waste Management New Zealand Limited and Transpacific Industries Group Limited. Waste Management was a code company and the amalgamation was structured so that Waste Management was amalgamated into Transpacific (i.e. Waste Management would no longer exist). Waste Management shareholders received cash consideration in return for their shares. The Code did not apply to the transaction as the amalgamation did not result in Transpacific becoming the holder or controller of any Waste Management voting rights as that company went out of existence.

32. The Waste Management case is a clear example of a change of control of a code company being effected in a manner which completely avoids the various protections for shareholders contained in the Code.

33. Dissenting shareholders in respect of an amalgamation under Part XIII of the Companies Act have a minority buy-out right under section 110 of the Companies Act. This right is only available to shareholders who cast an opposing vote at the relevant shareholder meeting. Under the Code all shareholders in a code company can require to be bought out if a person becomes the dominant owner of the company but this right is only triggered when a person[10] becomes the holder or controller of at least 90% of the voting rights in the code company.

34. Like shareholders considering a code transaction, shareholders considering an amalgamation proposal must be provided with a document setting out the terms of the proposed transaction. Part XIII of the Companies Act sets out a list of specified information that must be included in the proposal. Part XIII also requires that the shareholders in the amalgamating companies must receive information about the constitution of the amalgamated company, minority buy-out rights and the material interests of directors in the proposal.

35. There is no requirement in the Companies Act that shareholders receive a report on the merits of a proposed amalgamation from an independent adviser. An independent appraisal report may be required by the Listing Rules if the relevant code company is a party to a listing agreement with the New Zealand Exchange Limited. Some companies proposing an amalgamation voluntarily obtain some form of appraisal report for shareholders.

[10] or two or more persons acting jointly or in concert

SCHEMES OF ARRANGEMENT UNDER PART XV OF THE COMPANIES ACT

36. Under Part XV of the Companies Act the Court has a broad power to declare any arrangement, amalgamation or compromise binding in respect of the company or companies concerned[11].

37. A scheme of arrangement under Part XV can take a wide variety of forms. It can be an amalgamation in the same form as under Part XIII but instead be carried out with Court supervision. It could also be the acquisition of a company by another company.

38. Under Part XV of the Companies Act the Court is free to determine what it shall take into consideration in approving scheme proposals and what processes are appropriate.

39. Before making a final order under Part XV the Court may, of its own volition or in response to an application from an interested party, make initial orders:

    (a) Requiring that notice be given to certain persons;

    (b) Requiring the holding of meetings and specifying the method of shareholder approval;

    (c) Requiring that a report be prepared and distributed: and/or

    (d) Specifying who is entitled to be heard on the application[12].

40. The Court also has the ability to make additional orders in relation to the scheme. The Court can use this ability to make orders to protect those who oppose the proposed scheme.

41. Unlike an amalgamation under Part XIII dissenting minorities do not have buy-out rights under section 110 in respect of schemes of arrangement.

42. Like an amalgamation, a scheme of arrangement will only have Code consequences if it results in a person becoming the holder or controller of more than 20% of the voting rights in a code company.

43. It is sometimes possible for parties increasing voting control in a code company under a scheme of arrangement to comply with both the requirements set down by the Court in respect of that scheme and the requirements of the Code in a similar manner to amalgamations, i.e. by seeking shareholder approval for an acquisition or allotment in compliance with the Code as well as in compliance with the requirements set down by the Court. In such situations shareholders would probably have two votes on the same transaction.

[11] section 236(1) of the Companies Act
[12] section 236(2) of the Companies Act

44. There are some circumstances in which compliance with the Code is required in respect of a transaction under a scheme but is not technically possible. The Panel has previously indicated that it is likely to grant exemptions to parties who cannot comply with the Code in respect of an acquisition or allotment under a scheme of arrangement. The conditions of any such exemption would be based on the principles of the Code. The Panel's policy on schemes seeks to ensure that the principles of the Code are not subverted by the use of a scheme, particularly in respect of the thresholds for approval of schemes.

45. However, it is possible to structure schemes to avoid the jurisdiction of the Code entirely. A scheme can be structured as an amalgamation where the code company goes out of existence or the scheme can provide for the cancellation of voting rights in a code company before any person acquires the relevant shares. In both cases the ultimate result is the same as if there were an acquisition under the Code but there is no breach of the fundamental rule because no person will become the holder or controller of voting rights in the code company under the scheme.

46. If a scheme in respect of a merger with or acquisition of a code company is structured in a manner that avoids the application of the Code, the transaction will proceed only on the basis of the requirements of the Court. The level of shareholder support and the procedure required for the transaction to be approved will be determined by the Court which has no obligation to take into account the principles of the code and the special protections for code company shareholders contained in the Code.

47. In the past two years two mergers structured as schemes of arrangement have utilised the technical device of cancelling voting rights attaching to shares in a code company before those shares were acquired. One of those transactions[13] was the scheme to merge Independent Newspapers Limited and Sky Network Television Limited. Both companies were code companies. Under the scheme a new company (Newco) acquired all of the shares in INL and Sky in return for scrip and cash consideration issued to the shareholders of INL and Sky. In order to avoid the jurisdiction of the Takeovers Code the scheme provided for the cancellation of all Sky and INL voting rights immediately before the shares were acquired by the Newco. Accordingly no person became the holder or controller of voting rights in an existing code company as a result of the scheme, even though Newco acquired all the shares in the two code companies. The Panel considers that this scheme was intentionally structured to avoid the provisions of the Code.

48. INL and Sky also relied on a class exemption for allotments under initial public offers to comply with the Code in respect of the allotment of shares in a new code company under a scheme[14].

49. It was the INL and Sky transaction which first prompted the Panel to further consider the relationship between the Code and the reconstruction provisions of the Companies Act.

---

[13] The other transaction was the merger of Wrightson Limited and Pyne Gould Guinness Limited

[14] The Panel has subsequently revoked the class exemption that was relied upon

RELATIONSHIP BETWEEN THE CODE AND RECONSTRUCTIONS UNDER THE COMPANIES ACT

EFFECT OF THE ABILITY TO CHOOSE DIFFERENT MECHANISMS TO ACQUIRE A CODE COMPANY

50. Under the current provisions of the Code and the Companies Act, parties can in some circumstances choose to effect a merger or acquisition of a code company by utilising either code mechanisms or the reconstruction provisions of the Companies Act, or a combination of those mechanisms.

51. The Panel considers that it is appropriate different mechanisms are available for effecting mergers or restructuring code companies. Each mechanism has its own commercial advantages and disadvantages. In different situations alternative mechanisms will be more appropriate.

52. However, even though a transaction may achieve the same outcome, i.e. the merger or acquisition of a code company, shareholders of the relevant code company will have different rights and protections depending on whether the transaction is undertaken within the jurisdiction of the Code or structured as an amalgamation or scheme in a manner which avoids the Code.

Differences between Code transactions and amalgamations and schemes

53. The Code prevents any person from increasing its control percentage above 20% of voting rights except in a manner that complies with the Code. Any person wishing to obtain shares which would otherwise result in a breach of the Code must make a code offer or seek shareholder approval for an acquisition or allotment of a specified number of securities.

54. Important differences between the operation of the Code and schemes and amalgamations are:

(a) *The level of shareholder support required for a transaction to proceed*

Under the Code an acquisition needs to be structured as a code offer with a minimum acceptance level of more than 50% or as an acquisition or allotment of a specified number of securities approved by disinterested shareholders.

Under the scheme and amalgamation provisions a transaction is approved by a special resolution of shareholders voting at a meeting. No shareholders are excluding from voting on such a resolution.

(b) *The information provided to shareholders in respect of a proposed transaction*

In respect of a code offer or code transaction shareholders must be provided with specified information to enable them to decide the merits of a transaction for themselves. An important aspect of the documents provided is a report

prepared for the shareholders by an independent adviser on the merits of the proposed transaction.

In respect of amalgamations and schemes the information required is not prepared for code company shareholders in particular. There is no requirement for an independent adviser's report.

(c) *The level of support required before shares in a code company can be compulsorily acquired*

Under the Code compulsory acquisition rights apply when a person becomes the holder or controller of at least 90% of the voting rights in a code company.

In respect of a transaction structured as a scheme or an amalgamation shares in a code company can in effect be compulsorily acquired if a special resolution is passed.

55. Of particular concern to the Panel, and market participants who have contacted the Panel, is the level of shareholder support, particularly minority shareholder support, required in order for a transaction structured as a scheme or an amalgamation to proceed.

56. If a merger transaction is structured as a takeover offer the bidder cannot compulsorily acquire shares in a target company which is a code company from shareholders unless it becomes the holder or controller of shares representing at least 90% of the voting rights in that company. By comparison, if the transaction is structured as a scheme or an amalgamation with the same ultimate result as a takeover offer, shares in the code company would be able to be compulsorily acquired with a much lower level of shareholder support, 75% of shareholders who vote at a meeting.

57. The difference in the shareholder approval requirements for code transactions and for schemes or amalgamations is particularly significant in situations where there is a large shareholder in the code company who is able to pass a 75% resolution on its own if a number of minorities do not cast a vote. For example, if a shareholder holds 51% of the voting rights in the code company, that shareholder's vote is likely on its own to determine the outcome of the resolution.

58. If a change of control of a code company occurs by means of a scheme or amalgamation the change is likely to occur with a lower level of shareholder support than is required under the Code.

59. Concern about the lower level of shareholder support required for transactions structured as schemes or amalgamations was recently expressed in respect of the amalgamation of Waste Management and Transpacific (referred to earlier in this paper).

60. A number of market participants, including brokers and shareholders, have said that they could not understand why a transaction which looked like a takeover and had the same effect as a takeover could be carried out under the amalgamation or scheme provisions under the Companies Act. In respect of the Waste Management

amalgamation some market participants had expressed the view that Waste Management shares were in effect being compulsorily acquired for cash consideration by Transpacific on the basis of a special resolution of Waste Management shareholders. They noted that Transpacific was not required to first become the holder or controller of 90% of the voting rights in Waste Management before compulsory acquisition applied. At the Waste Management meeting to consider the transaction the amalgamation proposal the special resolution was passed with a high majority but less than half of the voting rights in the company were exercised.

61. Some media commentators and market participants suggested that the Code is weak if it can be avoided easily by structuring a transaction as an amalgamation or a scheme which avoids the jurisdiction of the Code. They also suggested that in the future more parties wishing to acquire control of code companies would seek to utilise schemes or amalgamations and thus avoid the provisions of the Code.

62. The differences between information provided to shareholders in respect of a transaction is also important. In respect of a code transaction the shareholders of the code company will receive a document which contains information required by the Code on the merits of the transaction. An important part of such information is the report on the merits of the proposed transaction from an independent adviser approved by the Panel. These documents, in particular the independent adviser's report, are prepared from the perspective of shareholders of the code company. The provision of information required by the Code is intended to ensure that code company shareholders have sufficient information on which to make their own decision about the proposed transaction. The independent advisers' report is required to address more than fairness. It is intended to address the merits of the transaction, including the merits of not approving a transaction or accepting an offer.

63. In respect of a scheme or amalgamation outside of the Code, shareholders receive a document prepared for all of the merging entities and not tailored specifically to code company shareholders. It may contain an independent appraisal report if required by the listing rules. This is not the same as an independent adviser's report under the Code which is provided only for code company shareholders and which has the all encompassing requirement of a report on the merits of a transaction and not just a valuation.

64. The Panel is, like many market participants, concerned about the impact that the different shareholder rights and protections have on code company shareholders in respect of mergers and acquisitions.

65. The next part of this paper discusses why the Panel does not consider that the differences between the rights and protections available to shareholders in respect of different transactions which produce the same ultimate result are appropriate.

THE PANEL'S CONCERNS REGARDING THE USE OF SCHEMES AND AMALGAMATIONS INVOLVING CODE COMPANIES

66. The Panel is concerned about the effect of the relationship between the Code and the reconstruction provisions of the Companies Act, reflected in the recent use of devices to avoid the jurisdiction of the Code. The Panel is concerned that the intention of the Code is not fulfilled if the protections contained within it can be avoided by market participants.

67. The Takeovers Act, and the Code promulgated under that Act, were introduced following a period of intense debate flowing from the change of control of listed companies by stands in the market or over night transactions from which shareholders (often a majority of shareholders) were excluded.

68. When the Takeovers Act was passed the legislature decided that in respect of a certain class of companies, code companies, there should be restrictions on the mechanisms for effecting changes of control.

69. The Code is intended to grant special rights to shareholders of code companies to ensure that all shareholders are treated equally, have an opportunity to participate in such changes of control and are provided with information sufficient to enable them to make an informed decision on any proposed change of control.

70. The Panel believes that the Code is intended to apply in respect of all code companies and provide protection to all code company shareholders in respect of transactions involving changes of control (above the 20% threshold of the fundamental rule). This intention is demonstrated by rule 5 of the Code which states that parties cannot contract out of the Code[15]. It is also demonstrated by the fact that there were no statutory exceptions from the Code for changes of control resulting from schemes of arrangement or amalgamations.

71. The Panel considers that the policy and purpose of the Code is undermined if persons wishing to effect a change of control of a code company can avoid the disciplines of the Code entirely by choosing an alternative transaction structure not subject to those disciplines.

72. In the Panel's view it was not the intention of the drafters of the Code to leave the rights and protections which shareholders of code companies have in relation to a change of control to be determined by the form of the transaction structure utilised by parties wishing to change control of a code company. This can be seen from rule 6 of the Code which is based on the outcome of transactions irrespective of their nature. For example involuntary increases of control resulting from share cancellation or buy-back transactions are caught by the Code.

---

[15] Rule 5 of the Code states *"This code has effect despite any provision to the contrary in any agreement, constitution of a company or similar document relating to another body corporate, resolution of the security holders of a company or of any other body corporate, deed, or otherwise."*

73. However, because of the current relationship between the Code and the Companies Act some market participants are utilising schemes and amalgamations in a manner which avoids the jurisdiction of the Code. In such circumstances the rights and protections provided by the Code would not be available to code company shareholders in respect of a transaction involving a change in the control of the code company. This is demonstrated by the Waste Management transaction described earlier in this paper

74. The Panel considers that the use of amalgamations and schemes to avoid the Code is not consistent with the intention of the Code. It is the intention of the Takeovers Code to provide protections to all code company shareholders in respect of transactions involving changes of control. The Panel believes that at the time of the enactment of the Companies Act and the Takeovers Act it was not intended that the Companies Act should provide mechanisms to allow parties to avoid the shareholder protections provided by the Takeovers Code.

75. The Panel considers that some form of amendment to the Code and the Companies Act is appropriate to maintain the integrity of the takeovers market.

76. An amendment is necessary to ensure that the rights and protections available to code company shareholders in the event of a merger or acquisition are consistent and comparable irrespective of whether that merger or acquisition is structured as a code transaction or as a scheme or an amalgamation which avoids the jurisdiction of the Code.

77. The Panel considers that this can best be achieved by amending the Code and the Companies Act so that:

    (a) schemes and amalgamations are carved out of the Code completely; and instead

    (b) the principles of the Code are introduced into the provisions of the Companies Act dealing with schemes and amalgamations.

78. More specific details of the Panel's recommended amendments are set out later in this paper.

79. The Panel has reached this view after:

- Considering submissions made to the Panel in response to a paper on proposed changes to its policy on exemptions for schemes of arrangement;
- Considering ways to address issues arising from the relationship between the Code and the Companies Act;
- Issuing a discussion paper on schemes and amalgamation involving code companies and considering submissions made in response to that paper.

80. In the following section of this paper we discuss the Panel's paper on exemptions for schemes of arrangement and comments received in response to that paper on the use of schemes and amalgamations in respect of code companies. We also discuss the steps which the Panel took following receipt and consideration of those submissions.

81. The paper will then discuss the Panel's discussion paper on schemes and arrangements involving code companies, the submissions received in response to that paper and the Panel's response to those submissions.

THE PANEL'S DISCUSSION PAPER ON EXEMPTIONS FOR SCHEMES OF ARRANGEMENT DATED 4 APRIL 2006

82. The Panel first made comments to the market on the relationship between the Code and the reconstruction provisions of the Companies Act in the context of reviewing its policy on exemptions in relation to schemes of arrangement. In April this year the Panel issued a discussion paper on proposed changes to its policy on exemptions regarding schemes of arrangement[16] which discussed the practice of some companies using technical devices in the structuring of the scheme so as to avoid the jurisdiction of the Code.

83. As well as asking for comments on proposed changes to its exemption policy regarding schemes, the paper discussed the use of schemes as devices to avoid the Code. The paper asked respondents to address the following questions:

- *Is the status quo, i.e. that participants in schemes of arrangement must comply with the Code, appropriate?*
- *Are the devices being adopted by some companies to exclude certain aspect of schemes of arrangement from the Code's jurisdiction an appropriate use of the Court supervised scheme of arrangement process?*
- *Should the Court take into account the principles of the Code and the amalgamation provisions of the Companies Act in approving schemes of arrangement?*

84. Copies of the submissions received in response to the paper regarding exemptions for schemes are attached (Appendix B).

85. The Panel received comments from a number of market participants concerned about the relationship between the Code and the use of schemes and amalgamations in respect of code companies. The Panel's paper was released shortly after the Waste Management transaction was announced and it appears that concerns regarding that transaction led some respondents to comment of the Panel's paper.

86. A number of market participants could not understand why a transaction which looked like a takeover and had the same effect as a takeover could be carried out under the amalgamation or scheme provisions of the Companies Act. Concern was expressed that under the amalgamation Waste Management shares were in effect being compulsorily acquired for cash consideration by Transpacific on the basis of a special resolution of Waste Management shareholders, rather than Transpacific having to first become the holder or controller of 90% of the voting rights in Waste Management.

87. Some parties suggested to the Panel that the ability to use an amalgamation or a scheme to avoid the Code is a loophole in the Code which needs to be addressed.

---

[16] *Policy on exemptions from the Code for schemes of arrangement effected under the Companies Act 1993*, 4 April 2006, attached as Appendix A.

They suggested that if this loophole is not addressed the integrity of the New Zealand market and the confidence of the investors will suffer.

88. However, this was not a universal opinion. Some market participants advised the Panel that in their view the legislature intended that schemes and amalgamations be completely separate mechanisms from code transactions and that the Code is not intended to apply in respect of these mechanisms. In their view Part XIII and Part XV provide protections for shareholders, in the form of minority buy-out rights and Court approval respectively, and the legislature intended that these protections on their own are sufficient in respect of reconstructions under the Companies Act. Market participants expressing this view considered that if the legislature had intended that Code principles should be taken into account by the Court in considering schemes of arrangement then Part XV would have been amended to require this when the Code was introduced.

89. Having considered its own experience regarding schemes and amalgamations involving code companies and the submissions received on its paper on exemptions for schemes, the Panel decided that the issues regarding the inconsistencies inherent in the use of amalgamations and schemes to effect mergers or acquisitions involving code companies outside the jurisdiction of the Code needed to be addressed.

90. The first step for the Panel was to consider what steps it could take to address these issues within the provisions of the Code and the Companies Act.

91. The Panel decided that to address the use of schemes as devices to avoid the rights and protections of the Code it would:

- seek to be heard by the High Court when the Court considers proposed schemes of arrangement involving code companies in the future; and

- revoke the class exemption for initial public offers which had been relied upon in respect of some schemes of arrangement to effect a merger by creation of a new company.

92. The Panel's reasons for seeking to be heard by the Court in respect of future schemes of arrangement and revoking the class exemption are set out in the Panel's press release in respect of these matters, dated 15 May 2006, attached as Appendix C.

93. These measures are the only course of action available to the Panel under the current legislative framework of the Code and the reconstruction provisions of the Companies Act. Clearly these measures would not be a sufficient solution to the problems which some market participants urged the Panel to address:

- These measures would not address the problems relating to amalgamations involving code companies which are framed in such a way that they are outside the jurisdiction of the Code, as the Court is not involved in such a process.

- Seeking to make submissions to the Court will not necessarily result in the provisions of the Code being taken into account in respect of proposed schemes. The Panel has no formal standing in respect of applications to the Court regarding

schemes of arrangement and the Court has no statutory direction regarding its treatment of such submissions. The Panel has not yet had the opportunity to make any submissions to the Court regarding a proposed scheme of arrangement. It is uncertain what weight the Courts would give to such submissions or indeed if they will hear the Panel.

94. The Panel considers that if the issues regarding the inconsistencies inherent in the use of amalgamations and schemes of arrangement to effect a merger with, or acquisition of, a code company outside of the jurisdiction of the Code are to be addressed satisfactorily this will require some form of amendment to the Code and the Companies Act.

95. The Panel decided that before making recommendations to the Minister on what it considers are desirable changes to the law, it should seek market comment on issues arising from the use of schemes and amalgamations in respect of code companies and possible solutions to problems arising from the use of schemes.

THE PANEL'S DISCUSSION PAPER ON SCHEMES AND AMALGAMATIONS INVOLVING CODE COMPANIES DATED 19 JUNE 2006

96. Based on its own experience and the submissions made in respect to the Panel's paper on its policy for exemptions for schemes of arrangement the Panel prepared a discussion paper on schemes and amalgamations involving code companies[17]. The paper was issued on 19 June 2006.

97. The discussion paper sought general comments on:

- the relationship between the Code and the reconstruction provisions of the Companies Act;
- suggested amendments to the Code and the Companies Act in relation to the use of schemes and amalgamations in respect of code companies.

98. We discuss separately below the responses received on the general relationship between the Code and the Companies Act and the responses received on the suggested amendments to the Code and the Companies Act.

Relationship between the Code and the Companies Act

99. The discussion paper asked respondents to address the following general questions about the relationship between the Code and the reconstruction provisions of the Companies Act:

- *Is it appropriate that mechanisms for changes of control which achieve the same result and have the same effect on shareholders of code companies should provide shareholders with comparable rights and protections?*
- *Do you consider that schemes and amalgamations should be completely separate mechanisms from code transactions and that the Code should not apply in respect of those mechanisms?*

  OR

- *Do you consider that the Panel should recommend some form of amendment to the Code and the reconstruction provisions of the Companies Act to address issues arising from the use of schemes of arrangement and amalgamations outside of the jurisdiction of the Code to effect mergers with or acquisitions of code companies?*

100. The Panel received submissions in response to its discussion paper from the following respondents:

(a) ABN AMRO Craigs;
(b) Brian Wheeler BComm, ACA (retired);

[17] A copy is attached as Appendix D.

(c) New Zealand Law Society (Commercial and Business Law Committee);
(d) Simpson Grierson;
(e) Grant Samuel & Associates;
(f) New Zealand Exchange Limited ("NZX");
(g) Harmos Horton Lusk;
(h) Paul Ridley-Smith, Morrison & Co;
(i) Bell Gully;
(j) Cameron Partners;
(k) Chapman Tripp Sheffield Young.

The submissions are attached as Appendix E.

101. Most submissions received recognised the need for an alternative transaction structure to a code offer to be available in some circumstances. However, there were mixed responses as to whether the current relationship between the Code and the reconstruction provisions of the Companies Act is appropriate.

102. Of the eleven submissions received six were broadly of the view that all structures achieving the same type of result for the shareholders of code companies should be subject to the same threshold requirements and have the same protections for minority shareholders. These submissions indicated a desire for consistency as to the rights and protections shareholders have in respect of any change of control regardless of the mechanism utilised by the companies concerned. These six submissions were broadly in favour of some form of legislative change to achieve this. One submission from Paul Ridley-Smith stated that:

> "*Legislative change is required to make substantially neutral, in-so-far as the application of the Code's objectives and principles, the choice of schemes of arrangement, amalgamations and takeover offers*".

103. The submission of the New Zealand Exchange stated:

> *"We believe the mechanisms for changes of control which achieve the same result and have the same effect on shareholders should provide comparable rights and protections to shareholders. Presently the opportunity exists for market participants to arbitrage between different regulatory regimes where those two regimes are designed to effect the same outcome. NZX agrees that this arbitrage opportunity needs to be closed. We do not consider that differing regimes for changes of control should permit different treatment in the following essential areas:*
>
> - *Information provided to shareholders;*
> - *Voting thresholds and voting restrictions;*
> - *Compulsory acquisition levels.*

104. ABN Amro Craigs suggested that if there are compelling reasons for the proposed amalgamation or merger then the parties proposing these should be comfortable with providing the same protections that minority shareholders enjoy under the Code.

105. Once again the view that there should be consistency as to the protections available to code company shareholders in respect of Code transactions, schemes and amalgamations was not universal.

106. Four of the eleven submissions received on the Panel's discussion paper suggested that schemes and arrangements are intended to be treated differently from Code transactions.

107. These submissions stated that it is not correct to regard the protections contained in the Code as "superior" to those that exist under the amalgamation and scheme provisions in the Companies Act. The submissions noted that the Companies Act provides different protections for shareholders in respect of amalgamations and schemes which are designed to reflect the different range of transactions that they cover. These respondents suggest that although these protections are not identical to those which apply in respect of Code transactions, they are not intended to be. They say that they are sufficient and appropriate in respect of the types of transactions carried out by way of a scheme or amalgamation.

108. Some respondents also stated that the Companies Act provisions contain important protections in respect of schemes and amalgamations which are not necessarily present in takeovers under the Code. In particular they noted the following:

(a) Amalgamations and schemes require the active support of the directors of the code company involved in the amalgamation or scheme;

(b) Amalgamations and, generally, schemes, require the approval of 75% of shareholders voting at a meeting. Under the Code increases in voting rights which may affect control can in some circumstances be effected with a vote of only a majority of shareholders voting at a meeting;

(c) Schemes require the approval of the Court, which reviews the transaction carefully to determine whether it is in the interests of all affected parties, including shareholders. There is no equivalent role played by the Panel under a takeover and the Panel has no duty or function to review the substance of a takeover on behalf of shareholders;

(d) In respect of an amalgamation under Part XIII of the Companies Act dissenting shareholders have minority buy-out rights i.e. the right to have their shares acquired at a fair value. There is no equivalent provision under the Code. While the Code has a compulsory acquisition regime applying when a shareholder holds or controls 90% of the voting rights, such a level of control is not required in order for minority buy-out rights to be available in respect of an amalgamation.

109. It was suggested that the Panel is overreacting to possible difficulties arising in respect of the use of schemes and amalgamations in respect of code companies as in the five years since the Code was introduced only three transactions appear to have been structured as schemes or amalgamations to avoid the provisions of the Code.

110. However, of the four submissions which stated that schemes and amalgamations are intended to be treated differently from Code transactions, two submissions expressed the view that there may be arguments to prevent the use of schemes or amalgamations where a transaction is being structured for the sole purpose of avoiding the operation of the Code in a way that prejudices shareholders.

The Panel's response to submissions on the relationship between the Code and the Companies Act

111. The Panel has considered the submissions made in response to its discussion paper on the relationship between the Code and the provisions of the Companies Act relating to schemes and amalgamations.

112. Prior to issuing the discussion paper the Panel had reached the view that the ability to use schemes and amalgamations to avoid the Code was inconsistent with the intention of the Code.

113. There is considerable support for the Panel's view that there should be a change of law to ensure that there is consistency as to the rights and protections code company shareholders have in respect of any change of control regardless of the mechanism utilised by the companies concerned.

114. There was also opposition to the need for a law change. However, the Panel notes that two of the four respondents which stated that there is no need for consistency of shareholder protections in respect of Code transactions, schemes and amalgamations acknowledged that the using a scheme or amalgamation may not be appropriate in all circumstances. There was an acknowledgement from those parties that in certain circumstances the use of a scheme or an amalgamation in a manner that avoids the Code could prejudice shareholders. We suggest that this prejudice occurs because the purpose and intent of the Code is not reflected in the provisions of the Companies Act in relation to schemes and amalgamations.

115. The Panel is not satisfied that the legislature intended that schemes and amalgamations should be able to be used as devices to avoid the Code and the protections it provides.

116. Some parties opposed to a law change note that it appears that schemes and amalgamations have only been used three times as a device to avoid the provisions of the Code. However, the Panel is concerned that the loophole exists and can be exploited. Now that the devices to avoid the Code have been well publicised their usage can be expected to increase, particularly if they appear to be sanctioned by the absence of a law change.

117. Taking into account the submissions made in response to the discussion paper on law changes, submissions on the questions raised in the earlier paper on exemptions for schemes, market comment and the Panel's own experience, the Panel is still firmly of the opinion that an amendment to the Companies Act and the Code is necessary to ensure the integrity of the takeovers market is maintained.

Amendments to the Code and the Companies Act contained in the Panel's discussion paper

118. In some circumstances the use of an amalgamation or scheme of arrangement may be commercially justified.

119. After initial consideration of the issues arising from the relationship of the Code and the reconstruction provisions of the Companies Act, the Panel considered that it was important to:

- ensure consistency in respect of the rights and protections of code company shareholders in the context of mergers and acquisitions regardless of the mechanism utilised to effect such a transaction; and

- preserve the rights of companies to choose which means of changing control they use.

120. The Panel considers that this can best be achieved by amending the Code and the Companies Act so that:

(a) schemes and amalgamations are carved out of the Code completely; and instead

(b) the principles of the Code are introduced into the provisions of the Companies Act dealing with schemes and amalgamations.

121. The Panel's discussion paper set out this proposal and how it would apply in respect of schemes and amalgamations.

122. We set out separately in respect of schemes and amalgamations:

- The Panel's proposed amendments to the Code and the Companies Act; and

- Responses received in response to the Panel's suggested amendments.

Schemes of arrangement

123. The Panel's discussion paper suggested that to avoid problems resulting from the Code applying to some schemes and not others and to also address the difficulties resulting from trying to comply with the provisions of both the Code and the Companies Act, they could be amended as follows:

(a) the Code could be amended to no longer apply to changes of control resulting from a scheme of arrangement under Part XV of the Companies Act; and

(b) Part XV of the Companies Act could be amended to require that with schemes of arrangement affecting code companies:

(i) the Courts take into account the principles of the Code when deciding what the appropriate process to be adopted for the approval of a scheme of arrangement, including the level of shareholder approval required and the information that needs to be provided to shareholders; and

(ii) the Court receives and takes into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved.

124. Such an amendment to Part XV of the Companies Act would not require the Court to follow or implement the recommendation of the Panel. However, if the legislature were to approve such an amendment the Courts would have a clear direction as to the legislature's intention that protections for shareholders contained in the Code should be reflected in the Court's requirements for approval of the scheme.

125. The Panel's discussion paper proposed that the Court, and the Panel in making recommendations to the Court regarding a proposed scheme, should take into account the principles of the Code.

126. By considering the principles of the Code the Courts could ensure that the rights of shareholders of code companies are not detrimentally affected by the mechanism used to effect a change of control.

127. A provision for the Panel to provide recommendations would assist the Court in its consideration of the application of the principles of the Code.

128. Under the current provisions of Part XV of the Companies Act the Court is presented with submissions from only the parties to the proposed scheme of arrangement. There is a procedure for shareholders to be heard but this requires shareholders to take affirmative action. Some shareholders may not understand all of the issues involved in a scheme and the differences between a scheme and a code transaction. If the Court were required to take into account recommendations from the Panel, it would have a wider range of views to help it to make its decision regarding what requirements are needed to protect the rights of code company shareholders.

129. The suggested amendment would be similar to the current provisions of the Takeovers Act in respect of orders in the event that a person does not comply with the Code. Parties can apply to the Court for a number of orders which are within the discretion of the Court. Under section 38 of the Takeovers Act the Court may in determining any application for orders consider any determination made by the Panel under section 32 of the Act or any recommendation made by the Panel at a meeting under section 32 or at the request of the Court.

130. The approach suggested by the Panel would be consistent with the requirements regarding schemes of arrangement in other jurisdictions, particularly Australia and the United Kingdom. In both Australia and the United Kingdom, where schemes of arrangement are recognised as an important mechanism for effecting changes of control, it is a requirement that a scheme does not offend the takeovers regime.

131. The legal requirements regarding schemes in Australia are especially important to consider in the interests of harmonisation between takeovers code requirements in Australia and New Zealand.

132. Schemes of arrangement in Australia are governed by Chapter 5 of the Corporations Act. Takeovers are governed by Chapter 6 of the Corporations Act. Section 411(17),

Chapter 5, of the Corporations Act provides that a Court cannot approve a scheme of arrangement unless:

(a) The Court 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 of the Corporations Act (i.e. the takeover provisions); or

(b) The Australian Securities and Investment Commission provides a "no objection" statement.

133. We understand that the Australian Securities and Investment Commission's current practice is to issue no-objection statements if it is satisfied that the Eggleston Principles are being broadly met by the scheme of arrangement.

134. The Eggleston Principles are the objectives of Chapter 6 of the Corporations Act. These principles are set out in section 602 which states that the purpose of chapter 6 (the provisions regulating takeovers) is to ensure:

(a) the acquisition of control over a relevant entity takes place in an efficient, competitive and informed market;

(b) the holders of the shares or interests, and the directors of the company or body or the responsible entity for the scheme:

(i) know the identity of any person who proposes to acquire a substantial interest in the company, body or scheme,

(ii) have a reasonable time to consider the proposal, and

(iii) are given enough information to enable them to assess the merits of the proposal; and

(c) as far as practicable, the holders of the relevant class of voting shares or interests all have a reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company, body or scheme; and

(d) an appropriate procedure is followed as a preliminary to compulsory acquisition.

135. The Panel's discussion paper asked market participants for their view regarding the suggested amendments to the Code and Companies Act. Respondents were asked to address the following questions in particular:

- *What are your views on the Panel's proposal that the Code and the Companies Act could be amended so that:*
    - *schemes and amalgamations are carved out of the Code completely; and instead*
    - *the principles of the Code are introduced into the provisions of the Companies Act dealing with schemes and amalgamations?*

- *Should the Court be required to take into account the principles of the Code in approving schemes of arrangement?*

- *In respect of schemes of arrangement, what are your views on an amendment which would provide that:*

    - *the Code no longer applied to changes of control resulting from a scheme of arrangement under Part XV of the Companies Act;*

    - *in deciding what the appropriate process adopted in respect of a scheme of arrangement should be Courts have to take into account the principles of the Code; and*

    - *before approving a scheme of arrangement the Court would have to receive and take into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved?*

- *Would such amendments address concerns that some market participants have regarding the use of schemes of arrangement in respect of code companies? Are there other alternatives which market participants would like to suggest?*

- *What are your views on the possible compliance costs of such amendments to the Code and Part XV of the Companies Act?*

Submissions on Proposed Amendments regarding Schemes of Arrangement

136. The Panel received a number of different views on its suggested amendments to the Code and the Companies Act regarding schemes.

137. Most submissions in favour of comparability of rights and protections available to shareholders of code companies regardless of whether a merger is structured as an offer, scheme or amalgamation, are generally supportive of the Panel's proposed amendments.

138. ABN AMRO state that the Courts should be required to take into account the principles of the Code in approving schemes of arrangement. They express the view that the recommendations of the Panel would assist the Courts in determining whether the proposed scheme or amalgamation complies with the broader provisions of the Code.

139. The NZX and Harmos Horton Lusk express similar views.

140. Harmos Horton Lusk state that the Courts should be obliged to take into account the views of the Panel and the Panel should have the ability to be heard at the first hearing prior to the Court making orders at the request of the applicant with regard to the convening of meetings, voting thresholds etc.

141. Harmos Horton Lusk note that there is no "amicus curiae" requirement in the scheme legislation. They suggest that this deficiency would be remedied by giving the Panel standing to appear at the first hearing and by allowing other interested parties sufficient notice to be heard also.

142. Two submissions which are supportive of the need for changes to the Code and the Companies Act regarding schemes expressed concerns about the changes proposed by the Panel:

(a) Mr Wheeler, an investor and retired accountant, is concerned that if the Code no longer applied to schemes the Courts could be persuaded by clever argument to approve schemes in a manner not consistent with the intentions of the Code or Takeovers Act to the detriment of minority shareholders. He states that if schemes were to be carved out the Code, the need to maintain the principles of the Code would need to be absolutely clear;

(b) Paul Ridley-Smith did not support legislative changes that provide the High Court or the Panel with wider discretions. In his view such amendments would increase uncertainty for the market. He made an alternative suggestion which is discussed below.

143. The main reservation expressed by parties supportive of the Panel's suggested amendments is the meaning of the term "the principles of the Code" in the context of the Courts consideration of a proposed scheme and the Panel's recommendations to the Court.

144. The NZX notes that in the absence of further guidance being provided it is likely that the meaning of the term will be a matter for submissions at the time the Court is considering a scheme. NZX state that whilst this may be appropriate the market will favour advance certainty as this makes doing business less costly and more timely to effect.

145. The parties which consider that the current relationship between the Code and the reconstruction provisions of the Companies Act is appropriate and that there is no need for consistency of shareholder protections (Bell Gully, Simpson Grierson, Chapman Tripp and Cameron Partners) are not in favour of the amendments suggested by the Panel regarding schemes and amalgamations.

146. They do not consider that the Court should be required to consider the principles of the Code in respect of a proposed scheme. In their view it is important that the Court retains a wide discretion, currently conferred by Part XV of the Companies Act, to be exercised in accordance with principles established by the body of case law that has developed over many decades.

147. Submissions opposed to the Panel's suggested amendments regarding schemes of arrangement state that shareholders of code companies already have sufficient rights and protections in respect of scheme proposals because they require the active support of the directors of the code company and the approval of the Court, which determines the required level of shareholder support for a transaction to proceed.

148. Simpson Grierson suggest that instead of an approach based on code principles it may be more appropriate to instead reinforce and clarify the role of the board of a company which is the subject of a scheme in respect of the scheme approval process.

They suggest that clarifying the role of the board would ensure that the interests of code company shareholders are properly taken into account.

149. Cameron Partners also suggest that target company shareholders are better served by current duties of directors than the proposals outlined in the discussion paper. They note that boards have a fiduciary responsibility to act in the best interests of all shareholders and have specific knowledge about the code company and the proposed transaction to effect this.

150. However, some of those parties suggest that it may be appropriate for the Panel to seek to be heard by the Court in respect of some proposed schemes but they do not consider that Panel submissions should be given any particular status. The weight to be given to Panel submissions should be a matter for the Court to decide. One party suggest that the Panel should only be permitted to make submissions when a shareholder of the code company has objected to the arrangement.

151. Parties opposed to the Panel's suggested amendments regarding schemes also expressed concern about meaning of "principles of Code". They state that the phrase lacks clear meaning and parties seeking to enter into substantial transactions require certainty on which to plan and commence a transaction.

152. Simpson Grierson suggest that the Panel should identify a set of criteria by which it could evaluate schemes in order to determine whether the principles of the Code are adequately addressed. They suggest that any decision to require the Court to take into account the principles of the Code when considering whether to approve a scheme should only be against a clear statement as to those principles and the manner in which they are to be applied.

153. Two of the respondents, Bell Gully and Simpson Grierson, although opposed to the Panel's proposed amendments, suggest that there may be grounds to introduce some amendments to the Companies Act to prevent the use of schemes of arrangements where a transaction is being structured as a scheme for the sole purpose of avoiding the operation of the Code in a way that prejudices shareholders.

154. Bell Gully suggest that to prevent the use of schemes where a transaction is being structured as an arrangement for the sole purposes of avoiding the operation of the Code in a way that prejudices shareholders a test similar to that in section 411(17) of the Australian Corporations Law could be adopted i.e. that a scheme can only be used to effect a merger involving a code company if the relevant regulator provides a "no objection" letter or the Court is satisfied that a scheme is not being utilised to avoid the requirements of takeovers law.

155. Simpson Grierson also discussed the Australian approach in their submission. However, they referred to difficulties the Panel had in applying the compelling reasons test in its policy on exemptions for schemes and are concerned that the same issues would arise in determining which schemes the Panel should seek to prevent. In their view any subjective test has the potential of putting the Panel in a position where it might be accused of merit regulation.

156. The Panel received some alternative suggestions to the proposed amendments set out in its discussion paper.

157. While generally supportive of the need for consistent protection for shareholders regardless of a merger mechanism, Paul Ridley-Smith does not support legislative changes that provide the High Court or the Panel with wider discretions. In his view such amendments would increase uncertainty for the market. Mr Ridley-Smith suggests that in certain circumstances where there is a suspicious choice of procedure the Code should apply directly. He considers that one of the strengths of the Code is that an experienced practitioner can by reading the Code get a good idea of what is or is not permissible. That benefit would be lost if a general discretion is given to the High Court.

158. Michael Lorimer of Grant Samuel suggests that changing the compulsory acquisition threshold in the Code to 75% of outstanding shareholders at the time of a transaction would be appropriate.

Compliance costs

159. In the discussion paper the Panel suggested that the direct costs and compliance costs resulting from the amendments discussed above may not be significant. Under the current provisions of the Companies Act parties make submissions to the Court and hold shareholder meetings. The introduction of Code principles into this process would not appear to significantly increase the cost of putting a scheme proposal to shareholders. The Panel suggested that the additional level of disclosure should not impose significant costs. It suggested that the only significant additional direct cost would be the cost of appointing an independent adviser, although we note that market practice does appear as a matter of course to embrace the appointment of an independent adviser for the preparation of an appraisal report.

160. Any increases in direct costs and/or compliance costs may be mitigated by the fact that as a result of the proposed amendments parties wishing to utilise the scheme provisions of the Companies Act, that are required to comply with the Code, would not need to apply to the Panel for exemptions from the Code.

161. NZX state that in respect of transactions of this nature compliance costs tend not to be a fundamental driving issue. The costs of the amendments to the Code and the Companies Act proposed by the Panel does not cause NZX concern.

162. Harmos Horton Lusk, who have advised a number of clients in respect of mergers and takeovers, state that in their experience compliance costs are not a material issue in transactions of this nature and scale.

The Panel's response to submissions on proposed amendments regarding schemes of arrangement

163. Having reviewed the submissions received the Panel considers that the proposed amendments regarding schemes are appropriate and necessary to address the problems arising form the use of schemes in respect of code companies.

164. The Panel notes that parties which indicated a desire for consistency as to the rights and protections of shareholders in respect of any change of control of a code company, regardless of the mechanism utilised are generally supportive of the Panel's suggested amendments.

165. The Panel notes the submissions which state that there are sufficient protections in place for code company shareholders in respect of schemes in the because of the requirement for a special resolution of shareholders and the fiduciary obligations of directors. The Panel does not agree. A change of control of a code company can occur under a scheme with a lower level of shareholder support than is required under the Code without providing the type of information that shareholders would receive under the Code. As previously stated the Panel does not consider that this outcome is consistent with the Code.

166. The deficiency in the relationship between the scheme provisions of the Companies Act and the Code is demonstrated by transactions such as the merger of INL and Sky. It should also be noted that the Waste Management amalgamation transaction could have been structured as a scheme with the same outcome.

167. The Panel notes that the main concern which parties have expressed in respect of the proposals was the uncertainty of the term "principles of the Code" and as to the recommendations that the Panel would be likely to make to the Court in respect of proposed schemes.

168. The Panel considers that this concern can be addressed by clarifying its interpretation of the principles of the Code in the context of the proposed amendment and giving an indication of the likely recommendations that the Panel would make to the Court.

The meaning of the "Principles of the Code" in the context of the proposed amendments

169. As indicated earlier in this paper, the intention of the Code is to ensure that all shareholders of a code company are able to participate in a change of control of a code company in accordance with rules which ensure equal treatment and the provision of information to enable shareholders to make an informed decision. Accordingly the recommendations of the Panel in respect of a proposed scheme will focus on:

(a) The information provided to shareholders in respect of the proposed transaction;

(b) The level of shareholder approval required for a transaction to proceed and who is entitled to vote on the relevant resolution; and

(c) The level of control required before compulsory acquisition provisions apply.

170. In terms of the type of information that the Panel will recommend should be provided to code company shareholders, this will reflect what would have been provided to shareholders in respect of a code transaction, including a report prepared by an independent adviser on the merits of the transaction. We note that the Panel did not receive many comments about the need for consistency regarding information

provided to code company shareholders. There seemed to be a general acceptance that it was appropriate for the same type of information to be provided.

171. Regarding the level of shareholder approval that the Panel would generally consider to be consistent with the principles of the Code, the Panel would not always seek to impose identical requirements to those contained in the Code. These may not be appropriate in every situation, particularly as schemes involve a meeting procedure and not an offer to each individual shareholder. The Panel would take into account the principles of the Code and the requirements of the Code which reflect those principles.

172. These principles are reflected in the three key requirements of the Code in relation to changes of control:

(a) *The 20% threshold in the fundamental rule* –The fundamental rule which prevents any person from becoming the holder or controller of more than 20% of the voting rights in a code company except in a manner that complies with the Code. If any person already holds or controls more than 20%, then that person's control percentage cannot be further increased except as permitted by the Code;

(b) *The 50% minimum acceptance rule* – which in effect requires that in order to proceed a takeover offer has to receive the support of the holders of the majority of voting rights in the company (including the voting rights held or controlled by the offeror); and

(c) *The 90% compulsory acquisition threshold* – this threshold establishes a level which must be reached before a person can be compelled to sell their shares. It also establishes a level at which the majority shareholder should have the right to buy-out minorities and minorities should have the right to be bought out of a code company;

(d) *Voting entitlement* – the provisions of the Code which govern meeting procedures for approval of allotments or purchases of shares recognises that those involved in a transaction, and who promote or formulate a transaction, and their associates, should be excluded from the vote on the proposed allotment or acquisition.

173. The Panel would seek to reflect the principles behind these key requirements in making its recommendations to the Courts under the proposed amendments in respect of appropriate shareholder approval thresholds.

174. In respect of exemptions for schemes the Panel has previously indicated that as a condition of exemption it would generally apply a voting threshold of 75% of the votes cast by those entitled to vote and who vote at the meeting, including by proxy, and being more than 50% of the total voting rights of the target company (the "75/50 threshold requirement").

175. The Panel considers that such a requirement would be appropriate as an initial threshold for approval of schemes under an amended Companies Act. The 75%

requirement is consistent with the current requirements in the Companies Act regarding amalgamations and the current practice of the Courts in relation to schemes of arrangement. The inclusion of the requirement that the resolution represent more than 50% of the total voting rights in the company is consistent with the principle that a takeover transaction receive the support of the holders of the majority of voting rights in a code company.

176. However, the 75/50 threshold requirement will not ensure that code company shareholders have rights and protections consistent with the principles of the Code in every situation.

177. Where there is a wide spread of shareholders the 75/50 threshold requirement may be sufficient (subject to some further qualifications mentioned later).

178. However, this will not be the case in respect of a code company which has a major shareholder which has effective control of the code company. For example, if a shareholder holds 51% of the voting rights in the code company, that shareholder's vote is likely on its own to determine the outcome of the resolution.

179. In reality a board would have put the scheme proposal forward structured around the major shareholder's preferences. The scheme could not proceed without its support.

180. As noted in paragraph 172 the Code provides in meeting situations that parties who formulate and promote a transaction which requires shareholder approval cannot vote on a resolution in respect of that proposed transaction. The Panel considers that this principle should be reflected in the approval thresholds for schemes in addition to the 75/50 threshold requirement.

181. In the Panel's view a scheme proposal should be required to be approved by a special resolution[18] of those shareholders who were not involved in the formulation of the proposal ("independent shareholders"). Large shareholders will inevitably be involved in the formulation of the scheme proposal. As boards would be involved in the formulation of the scheme, board members and any shareholders they represent, and associates of those board members and shareholders, would also not be included as independent shareholders for the purposes of the vote.

182. The requirement for a special resolution of independent shareholders would be in addition to the initial 75/50 threshold requirement which would *include* all shareholders, including those involved in the formulation of the scheme.

183. Accordingly, the Panel's approach to a recommendation to the Court under the proposed amendment to the Companies Act would require the approval of the scheme by shareholders representing:

(a) At least 75% of the votes cast at a meeting at which all shareholders can vote, provided that the resolution represents more than 50% of the total voting rights in the code company; and

[18] Or 90% of total voting rights in the unlikely event that this is lower than the special resolution

(b) At least 75% of the votes cast at the meeting of independent shareholders.

184. This requirement recognises that:

(a) The support of parties who already control a significant percentage of shares in the company will usually be required (for the 75/50 threshold); *and*

(b) Shareholders who have been involved in the formulation and/or promotion of a scheme, and their associates, should not dominate or determine the outcome of a shareholder vote. Independent shareholders should have a real opportunity to participate in the decision as to whether to proceed with a scheme.

185. Schemes by their very nature involve compulsion – shareholders are bound by the scheme. It is acknowledged by the Panel that these requirements represent some softening of the 90% requirement for compulsory acquisitions under the Code. As a scheme is a meeting based procedure it is recognised that the 90% requirement would make it very difficult for any scheme to be approved. Consequently the requirements referred to in paragraph 183, which significantly expanded the standard 75% majority of all voting shareholders, are very important to strengthen the voting requirements as a balance to relaxing the 90% threshold.

186. The exception to the approach proposed in paragraph 183 is where the transaction does not involve what should be the underlying purpose of a scheme, namely a merger of shareholder interests, where shareholders of two companies end up as shareholders of a new company.

187. A transaction such as the Waste Management transaction is not a merger as it involves the exit of Waste management shareholders for cash. Consequently for a scheme of this nature the requirements of paragraph 183 would not be sufficient.

188. The Panel considers that in such situations the appropriate shareholder approval threshold for the transaction to proceed is a resolution which represents 90% of total voting rights of the code company, i.e. the compulsory acquisition threshold contained in the Code. Shareholders in a code company should be able to rely on the fact that their shares cannot be compulsorily acquired for cash unless a person becomes the holder or controller of, or commands the voting support of, at least 90% of the total voting rights in that company.

189. The Panel wrote to the eleven parties who had made submissions on the Panel's discussion paper asking them whether knowledge of the likely shareholder approval thresholds to be recommended by the Panel would address their concerns about the meaning of the terms "principles of the Code" in the context of the Panel's suggested amendments to the Code and the Companies Act.

190. Five of the eleven respondents to the discussion paper responded to the Panel's target consultation on this matter. Some of the respondents were supportive of the Panel's proposed approach. Some respondents again expressed concerns about the need for certainty.

The Panel's recommendation to the Minister regarding schemes of arrangement

191. Taking into account the views expressed by the market, submissions received on its proposed amendments and the relationship between the Code and the Companies Act, and its own concerns, the Panel in its function of keeping the law relating to takeovers under review recommends to the Minister that the provisions of the Code and the Companies Act be amended as follows:

(a) the Code be amended to no longer apply to changes of control resulting from a scheme of arrangement under Part XV of the Companies Act; and

(b) Part XV of the Companies Act be amended to require that:

(i) the Courts take into account the principles of the Code when deciding the requirements for approval of schemes of arrangement, including the level of shareholder approval required and the information to be provided to shareholders; and

(ii) before approving a scheme of arrangement the Court receives and takes into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved.

192. A copy of the suggested amendments to the Code and Part XV of the Companies Act are attached as Appendix H.

193. In terms of the Panel's recommendations to the Court as to the requirements to be met for a scheme to be approved, the Panel's recommendations would address:

(a) The information to be provided to code company shareholders in respect of the proposed transaction. The Panel considers that the information provided to shareholders should be consistent with the information which would be required in respect of a code transaction, including an independent adviser's report; and

(b) The level of shareholder approval required in order for the scheme to proceed.

194. In respect of recommending an appropriate shareholder approval threshold to the Court, the Panel would take the following approach:

- The Panel will first consider whether the proposed transaction is akin to a compulsory acquisition (or force out) or is in the nature of a merger of shareholder interests.

  If the transaction is a scheme in which code company shareholders are offered cash or other consideration for their shares and will not be continuing as shareholders in a merged entity, the transaction will be in the nature of a compulsory acquisition rather than a merger of shareholder interests.

In such situations the Panel would be likely to recommend to the Court that the appropriate shareholder approval threshold is 90% of total voting rights, i.e. the same as the compulsory acquisition threshold

- If the transaction is in the nature of a merger of shareholder interests the Panel would be likely to recommend that the scheme proposal be approved by:

    (i) At least 75% of the votes cast at a meeting at which all shareholders can vote, provided that the resolution represents more than 50% of the total voting rights in the code company; and

    (ii) At least 75% of the votes cast at the meeting of independent shareholders.

- The Panel would of necessity need to ensure that it considered the particular circumstances of each case in applying the guidelines described above.

195. The role of the Panel in respect of schemes involving code companies may increase under an amended Companies Act. The Panel will need to make recommendations to the Court and may be requested to appear before the Court.

196. It would be appropriate for parties proposing a scheme of arrangement to meet the costs of the Panel's involvement.

197. The Panel suggests that if the Code and the Companies Act are amended as it recommends, it would be appropriate for the Takeovers (Fees) Regulations 2001 to be amended to allow the Panel to recover its costs from parties to a scheme proposal.

Amalgamations

198. In its discussion paper the Panel suggested that to avoid problems resulting from the use of the amalgamation provisions of the Companies Act to effect a merger with or acquisition of a code company the Code and the Companies Act could be amended as follows:

    (a) the Code could be amended to no longer apply to changes of control resulting from an amalgamation under Part XIII of the Companies Act (with the definition of control being sufficiently broad to ensure that the alternative protections are not also avoided); and

    (b) Part XIII of the Companies Act could be amended to require that:

        (i) parties to a proposed amalgamation must obtain the approval of the Panel to the amalgamation process; and

        (ii) the Panel, in giving approval for an amalgamation process, take into account the principles of the Code.

199. The Panel suggested that its approval of an amalgamation process would be subject to conditions based on the principles of the Code.

200. The Panel did not suggest that in approving an amalgamation process it would always seek to impose identical requirements to those contained in the Code. The Panel would instead take into consideration the particular circumstances of the amalgamation. The Panel would look to apply the broader principles of the Code of equal treatment and fairness and the intentions of the Code thresholds.

201. This approach would continue to allow companies to utilise the amalgamation provisions of the Companies Act in respect of transactions involving code companies but in a manner that ensures that shareholders of code companies continue to have comparable or similar rights and protections to those provided by the Code.

202. The Panel also suggested that it may be appropriate to amend the minority buy-out provisions of the Companies Act in respect of amalgamations involving code companies.

203. The minority buy-out right in respect of amalgamations is only available to shareholders who cast a dissenting vote at a meeting held to consider an amalgamation proposal. Under the Code compulsory acquisition rights apply in respect of all outstanding shareholders i.e. all those who have not accepted a code offer. In addition under the Code when the compulsory acquisition price is challenged the price is determined by an independent expert, subject to certain requirements. Under the amalgamation provisions the price is fixed by arbitration.

204. The Panel's discussion paper highlighted these differences and asked market participants whether instead of having minority buy-out rights under the Companies Act, the Panel should have the power to impose as a condition of approval of any amalgamation proposal that all shareholders of the relevant code company have rights and protections consistent with the compulsory acquisition provisions of the Code.

205. The Panel's discussion paper asked respondents to address the following questions:

- *In respect of amalgamations, what are your views on an amendment to Part XIII of the Companies Act to require that parties to a proposed amalgamation obtain the approval of the Panel to the amalgamation process and that the Panel impose conditions on amalgamations which ensure that code company shareholders have rights and protections under the amalgamation proposal consistent with the principles of the Code?*

- *In respect of minority buy-out rights, do you consider that instead of dissenting shareholders having minority buy-out rights under the Companies Act the Panel should have the power to impose as a condition of approval of any amalgamation proposal that all shareholders of the relevant code company have rights and protections consistent with the compulsory acquisition provisions of the Code?*

- *Would such amendments address concerns that market participants have regarding the use of amalgamations in respect of code companies? Are there other alternatives which market participants would like to suggest?*

- *What are your views on the possible compliance costs of such amendments to the Code and Part XIII of the Companies Act?*

Submissions on proposed amendments regarding amalgamations

206. Most submissions which were in favour of comparability of rights and protections available to shareholders of code companies regardless of whether a merger is structured as an offer, scheme or amalgamation, are generally supportive of the Panel's proposed amendments in respect of amalgamations.

207. However, concerns were expressed about the meaning of the phrase "principles of the Code". These concerns are similar to those expressed about the meaning of the term in the context of the suggested amendments regarding schemes of arrangement.

208. The Business and Law Reform Committee of the New Zealand Law Society state that it is mindful of the uncertainty that may be created where amalgamations are subject to the approval of the Panel. They suggest that degree of uncertainty would be reduced if either:

(a) specific requirements or conditions for amalgamations involving code companies were included in the Companies Act (such as approval by 90% of code company shareholders if that is the Panel's general intention) and where those specific requirements or conditions were not appropriate in the circumstances the Panel would have the power to exempt certain transactions; or

(b) the proposed changes to Part XIII of the Companies Act contained a list of conditions which, if satisfied, will require the Panel to approve the amalgamation (i.e. where the applicant can show that the principles of the Code are not frustrated). This would allow the Panel discretion in circumstances where the list of conditions was not satisfied, but would allow no discretion (thereby providing certainty to applicants) where the list of conditions was satisfied.

209. NZX believes more clarity as to the circumstances under which the Panel would impose conditions on amalgamation proposals is critical. NZX states that there are cogent arguments both ways as to shareholders' rights – including the right to be apathetic. Merely giving the Panel the power to impose conditions does not provide sufficient clarity as to how, why and when such power would be used.

210. Harmos Horton Lusk's submission is supportive of the Panel's proposal regarding amalgamations. They state that they believe the natural concern which market participants will have as to the Panel "over reaching" in terms of the types of amalgamations and matters to be taken into account by the Panel determining to exercise its approval, can be adequately resolved.

211. Simpson Grierson, Bell Gully, Chapman Tripp and Cameron Partners are not supportive of the Panel's proposed amendments in respect of amalgamations.

212. Their main concern was the removal of a process which is fairly certain, with the level of shareholder approval required and the information to be included in a proposal being set out in Part XIII of the Companies Act, and the introduction of a process

dependent upon the application of the principles of the Code as interpreted by the Panel. This type of concern is perhaps greater in respect of amalgamations rather than schemes because the proposed change introduces a regulator into the amalgamation process where there currently is not one. The suggested amendments would mean that the Panel would determine the approval threshold and information requirements for an amalgamation proposal. These matters are currently set out in statute.

213. Parties who oppose the Panel's suggested amendments are of the view that Panel approval should not be a pre-requisite to the use of an amalgamation involving a code company and that the Panel should not impose conditions similar to those which apply in respect of a code offer. Those parties consider that the current amalgamation provisions provide adequate protection for shareholders. They suggest that the combined effect of the directors' fiduciary duties, the requirement for a special resolution and the availability of minority-buy-out rights are appropriate protections for minority shareholders.

214. Bell Gully state that the requirement for an amalgamation to be approved by a special resolution is sufficient protection for shareholders and accordingly the Panel's suggested amendments are unnecessary. They state that the fact that dissenting shareholders can exercise minority buy-out rights provides sufficient protection for minority shareholders. Bell Gully suggest that the minority buy-out provisions of the Companies Act confer protections on shareholders which are in many respects more extensive and effective that those provided under the Code.

215. Simpson Grierson suggest that any legislative amendment in this area should have as one of its objectives adding certainty so as to facilitate (and not discourage) commercial activity leading to changes in corporate control. They state that undermining the level of clarity or certainty about the criteria to be applied when reviewing comparable transactions is to be avoided as it only adds to the costs and risk associated with transactions which must be regarded as adding value to our economy and introduces an element of country risk which should be avoided in seeking to attract and retain capital for development.

216. Parties opposed to the Panel's suggested amendments also express concern about the shareholder approval thresholds that the Panel might impose as a condition of any approval.

217. Parties opposed to the Panel's suggested amendments are concerned that the Panel would impose a 90% approval threshold in every case because all amalgamations involve an element of compulsory acquisition. They have expressed the view that it may be undesirable to impose a 90% compulsory acquisition threshold on a transaction that is to be approved by a vote of shareholders (as opposed to acceptance by shareholders of an offer to acquire shares). Given that shareholder participation in votes is often relatively low, any requirement for 90% voting approval is likely to confer on a very small percentage of shareholders the ability to block a transaction even though it is supported by the directors and the vast majority of shareholders. In this respect it is argued that a 90% voting threshold is potentially very different from a 90% acquisition threshold, and far more difficult to obtain.

218. Simpson Grierson suggest that conferring on all shareholders of an amalgamating company rights similar to those of outstanding shareholders in respect of a takeover offer which has a 90% acceptance threshold is not appropriate in every case. They state that in the case of a takeover offer these 'hold outs' have not had the benefit of the board review process that leads to the approvals required in an amalgamation and accordingly are in need of the compulsory acquisition provisions of the Code.

219. There is not a great deal of support for the Panel introducing conditions in respect of amalgamation proposals which replicate the compulsory acquisition provisions of the Code.

220. Simpson Grierson and Bell Gully suggest that there is no need to amend the minority buy-out rights contained in the Code. They state that minority buy-out provisions and the compulsory acquisition provisions of the Code operate differently because they apply to different types of transaction. As noted above Bell Gully suggest that minority buy-out rights potentially apply in many circumstances when the compulsory acquisition provisions under the Code would not.

221. Harmos Horton Lusk state that they would be reluctant to see the minority buy-out facility removed. Perhaps a regime whereby minorities have the choice of proceeding under the minority buy-out regime, or alternatively exercising the "put option' formulation envisaged by the compulsory acquisition rules might be a suitable alternative.

222. ABN AMRO suggest that the minority buy-out provisions in respect of amalgamations involving code companies should be that in cases which are in effect a scrip based offer there should be a cash option available to shareholders who dissent.

223. However Simpson Grierson suggest there are one or two anomalies surrounding the level of information provided to minorities in respect of amalgamations under Part XIII of the Companies Act which require review, particularly:

    (a) The absence of a requirement for independent appraisal of the merits of the proposal; and

    (b) The requirement for a uniform treatment of all dissenting minorities.

Compliance costs

224. In terms of the compliance costs of the possible amendments to the Code and Part XIII of the Companies Act described above, an amendment of this nature would increase compliance costs for companies wishing to utilise the amalgamation provisions of the Companies Act because of the need to apply to the Panel for approval. Currently amalgamations take place without the involvement of any regulator. An amendment of the type discussed above would mean that code companies wishing to put an amalgamation proposal to shareholders would need to make an application to the Panel for approval of the proposed amalgamation process.

225. The Panel did not receive many comments on the issue of compliance costs regarding its proposed amendments as they related to amalgamations. The comments on the

Panel's proposals concentrated on issues of certainty. However, some parties who were opposed to the Panel's suggested amendments considered that amalgamations under an amended Companies Act would be more costly.

The Panel's response to submissions on proposed amendments regarding amalgamations

226. Having reviewed the submissions the Panel considers that its suggested amendments regarding amalgamations are appropriate and necessary to address the problems arising from the use of amalgamations in respect of code companies.

227. The Panel does not agree that the current amalgamation provisions provide sufficient rights and protections for code company shareholders. It notes that the rights and protections differ in the key areas of provision of information, shareholder approval thresholds and compulsory acquisition thresholds. The Panel considers that the intention of the Code to provide special protections to shareholders of code companies is not fulfilled if market participants can utilise the amalgamation provisions of the Companies Act to avoid the requirements of the Code.

228. The deficiency in the present legislation is demonstrated by the Waste Management case. It was in effect, and seen by the market as, a takeover done by way of an amalgamation to avoid the constraints of the Code. This deficiency needs to be dealt with if the integrity of the takeovers market is to be maintained.

229. The Panel notes that market participants have a desire for certainty and the amalgamation provisions allow transactions to occur with a level of certainty that may not be available in respect of a code transaction, particularly an offer, because the approval thresholds are lower. However, the Panel does not consider it appropriate that this certainty for parties promoting a merger or acquisition of a code company by way of amalgamation be obtained at the expense of shareholders of code companies by avoiding the rights and protections provided by the Code.

230. The primary focus for the protection of shareholders of code companies is the Code. If amalgamations are to be permitted in respect of code companies then the intention should be to maintain the protections of the Code. As the procedures for takeovers and amalgamations differ there needs to be some modification of the absolute requirements of the Code to take account of these differing procedures.

231. The Panel considers that these mechanisms need to be as far as possible consistent with the principles of the Code. The Panel as a regulator under the Code is in the best position to determine how the principles of the Code can be applied to amalgamations. As with takeover matters the Panel develops and disseminates policy papers. In this paper the Panel has already indicated the way in which it would exercise the powers contained in the proposed amendment to the Companies Act. The position with amalgamations in analogous to schemes of arrangement except without the overview of the Courts. However, there is consistency under the proposed amendments in that the Court will have the benefit of the recommendations of the Panel**.**

232. This level of discretion which the Panel will have in respect of amalgamations under an amended Companies Act should not deter market participants from using the amalgamation provisions of the Code. It would be no more uncertain that the current provisions of the Companies Act relating to schemes of arrangement. In respect of schemes the Court has a discretion to impose voting and other requirements as it considers appropriate. A body of practice has built up over time and parties consider this practice in making applications to the Court but the Court maintains an ultimate discretion. The Panel would take a similar approach to amalgamations under an amended Companies Act. The discretion which the Panel will exercise is also similar to the discretion that the Panel has to grant exemptions from the provisions of the Code.

233. The Panel also notes that if parties do not wish to submit themselves to the discretion of the Panel under an amended Companies Act they can still seek to effect an amalgamation under the scheme of arrangement provisions in the Companies Act. The transaction could be exactly the same transaction but effected as a scheme under the supervision of the Court. If an amalgamation was structured under Part XV of the Companies Act this would mean that minority buy-out rights would not apply but it would be open to the Court to include such rights as a condition of approval of a scheme.

234. The Panel notes that respondents expressed the same concerns about the meaning of the term "principles of the Code" in the context of the amendments regarding amalgamations as were expressed in relation to the proposed amendments regarding schemes.

235. Once again, the Panel considers that this concern can be addressed by clarifying its interpretation of the term in the context of the proposed amendments.

236. The interpretation of the principles of the Code and the areas which the Panel will focus on regarding conditions of approval of a scheme proposal will be the same as discussed in paragraphs 169 to 173 of this paper.

237. The type of information the Panel is likely to require to be provided to shareholders and the shareholder approval thresholds the Panel is likely to require as conditions of approval of a scheme are the same as those discussed in respect of schemes in paragraphs 174 to 188. Consistency between the requirements in respect of schemes and amalgamations involving code companies is important.

238. Accordingly, in order for shareholder approval of an amalgamation proposal to be consistent with the principles of the Code the Panel's approach would be that the proposal be approved by shareholders representing:

(a) At least 75% of votes cast at a meeting (by those entitled), provided that they represent more than 50% of the total voting rights in the code company; and

(b) At least 75% of the votes of "independent shareholders" cast at the meeting.

239. Once again the exception to this approach would be situations where the effect of the amalgamation transaction, if approved by shareholders, would be akin to a

compulsory acquisition rather than a merging of shareholder interests. In such situations the appropriate shareholder approval threshold for the amalgamation to proceed is a resolution which represents 90% of total voting rights of the code company, i.e. the compulsory acquisition threshold contained in the Code.

240. Some respondents to the Panel's discussion paper have suggested that any conditions which will be imposed in respect of amalgamation proposal should be set out in statute rather than left to the discretion of the Panel. They note that voting thresholds for amalgamations and the information to be provided to shareholders in respect of amalgamation proposals are currently set out in Part XIII of the Companies Act.

241. The Panel notes the desire of many market participants for certainty as to the voting and other requirements regarding amalgamation proposals. However, the Panel considers that flexibility needs to be maintained.

242. In some situations the information that would be required in respect of a code transaction will not be appropriate in respect of a particular amalgamation proposal. Likewise the same voting thresholds may not be appropriate in every case to ensure that code company shareholders have a real and effective opportunity to participate in a resolution regarding a change of control. Similarly it would be extremely difficult to make fixed rules about voting entitlements.

243. The Panel considers that it is appropriate and necessary to maintain some flexibility to allow individual circumstances to be catered for, provided that the principles of the Code are maintained.

244. In respect of minority buy-out rights the Panel notes that there was no significant support for an amendment of these rights as they applied to shareholders of code companies.

245. The Panel considers that it would not be appropriate to amend the minority buy-out provisions of the Companies Act in respect of amalgamations. These should continue to apply.

The Panel's recommendation to the Minister regarding amalgamations

246. Taking into account the views expressed by the market, submissions received on its proposed amendments and the relationship between the Code and the Companies Act, and its own concerns, the Panel in its function of keeping the law relating to takeovers under review has decided to recommend to the Minister that the provisions of both the Code and the Companies Act, those Acts be amended as follows:

(a) the Code be amended to no longer apply to changes of control resulting from an amalgamation under Part XIII of the Companies Act; and

(b) Part XIII of the Companies Act be amended to require that:

(i) parties to a proposed amalgamation must obtain the approval of the Panel to the amalgamation process; and

(ii) the Panel, in giving approval for an amalgamation process, take into account the principles of the Code.

247. A copy of the suggested amendments to the Code and Part XIII of the Companies Act are attached as Appendix H.

248. In terms of conditions which the Panel would impose as conditions of approval of an amalgamation proposal, the Panel would impose conditions regarding:

(a) The information to be provided to code company shareholders in respect of the amalgamation proposal (which should reflect that which would be required in respect of a code transaction); and

(b) The level of shareholder approval required in order for the scheme to proceed.

249. In respect of determining an appropriate shareholder approval threshold as a condition of approval:

- The Panel will first consider whether the proposed transaction is akin to a compulsory acquisition (or force out) or is in the nature of a merger of shareholder interests.

  If the transaction is an amalgamation in which code company shareholders are offered cash or other consideration for their shares and will not be continuing as shareholders in a merged entity, the transaction will be in the nature of a compulsory acquisition rather than a merger of shareholder interests.

  In such situations the Panel will impose as a condition of approval that the proposal is approved by shareholders holding 90% of total voting rights, i.e. the same as the compulsory acquisition threshold.

- If the transaction is in the nature of a merger of shareholder interests the Panel would be likely to require that the amalgamation be approved by:

  (i) At least 75% of the votes cast at a meeting at which all shareholders can vote, provided that the resolution represents more than 50% of the total voting rights in the code company; and

  (ii) At least 75% of the votes cast at the meeting of independent shareholders.

- The Panel would of necessity need to ensure that it considered the particular circumstances of each case in applying the guidelines described above.

250. An amendment of the Code and Companies Act as suggested by the Panel would mean that code companies wishing to put an amalgamation proposal to shareholders would need to make an application to the Panel for approval of the proposal amalgamation process. This would increase the costs to the Panel in respect of amalgamations involving code companies.

251. The Panel suggests that it would be appropriate for parties promoting amalgamation proposals to meet this cost.

252. The Panel suggests that the Takeovers (Fees) Regulations 2001 be amended to enable the Panel to pass the cost of considering applications regarding amalgamation proposals to those applicants.

CONCLUSION

253. The Code was introduced to address concerns about changes of control which occurred as the result of stands in the market and overnight transactions from which the majority of shareholders could be excluded. The intention of the Code is to maintain the integrity of the market by providing special protections and rights to shareholders of code companies. The purpose of the Code is to ensure that all shareholders of code companies are able to participate in a change of control of a code company in accordance with rules which ensure equal treatment and the provision of information sufficient to enable shareholders to make an informed decision.

254. However, there is a loophole resulting from the relationship between the Code and the provisions of the Companies Act relating to schemes and amalgamations which allows transactions involving the change of control of a code company to proceed in a manner not consistent with the intention of the Code.

255. Under the Companies Act it is possible to structure a transaction with the same ultimate result as a takeover under the Code, e.g. the acquisition of a code company, as a scheme or an amalgamation in a manner that avoids the jurisdiction of the Code. In such circumstances the rights and protections provided by the Code would not be available to code company shareholders even though the transaction would result in a change in the control of a code company.

256. If a change of control of a code company occurs by means of a scheme of arrangement or amalgamation, the change will take place with a lower level of shareholder support than is required under the Code and without providing the type of information that shareholders would receive under the Code, such as an independent adviser's report. The transaction may also result in the compulsory acquisition of shares in the code company at a level significantly lower than the compulsory acquisition threshold contained in the Takeovers Code.

257. The amalgamation of Waste Management and Transpacific is an example of the use of an amalgamation as a device to avoid the Code. That transaction was in effect and seen by the market as, a takeover done by way of an amalgamation to avoid the constraints of the Code.

258. The Panel believes that at the time of the enactment of the Companies Act and the Takeovers Act it was not intended that the Companies Act should provide mechanisms to allow parties to avoid the shareholder protections provided by the Takeovers Code.

259. The Panel is concerned that this loophole exists and can be exploited. Now that the devices to avoid the Code have been well publicised their usage can be expected to increase, particularly if they appear to be sanctioned by the absence of a law change.

260. The Panel considers that some form of amendment to the Companies Act and the Code is necessary to ensure that the integrity of the takeovers market is maintained.

261. The primary focus for the protection of shareholders of code companies is the Code. Accordingly, the Panel considers that if schemes and amalgamations are to be permitted in respect of code companies then the intention should be to maintain the protections of the Code. The Panel considers that the use of schemes and arrangements involving code companies needs, as far as possible, to be consistent with the principles of the Code.

262. The Panel considers that this can best be achieved by amending the Code and the Companies Act so that:

- Schemes and amalgamations are carved out of the Code completely; and instead
- The principles of the Code are introduced into the provisions of the Companies Act dealing with schemes of arrangement and amalgamations.

263. The Panel as a regulator under the Code is in the best position to determine how the principles of the Code can be applied to schemes and amalgamations. Accordingly the Panel recommends that it be involved in schemes and amalgamations as follows:

- In respect of schemes, the Panel would make recommendations to the Court (which it would be required to take into account) as to the requirements to be met for the scheme of arrangement to be approved;
- In respect of amalgamations, parties to a proposed amalgamation would need to obtain the approval of the Panel to the amalgamation process.

264. The Panel would in respect of both scheme and amalgamations seek to ensure that the principles of the Code are consistently reflected in requirements to be met for a transaction involving a code company to proceed.

The Panel recommends to the Minister that:

(a) the Takeovers Code would be amended to no longer apply to changes of control resulting from an amalgamation under Part XIII of the Companies Act or a scheme of arrangement under Part XV of the Companies Act;

(b) Part XIII of the Companies Act, which deals with amalgamations, be amended to require that:

(i) parties to a proposed amalgamation must obtain the approval of the Panel to the amalgamation process; and

(ii) the Panel, in giving approval for an amalgamation process, shall take into account the principles of the Takeovers Code; and

(c) Part XV of the Companies Act, which deals with schemes of arrangement, be amended to require that:

(i) the Courts take into account the principles of the Takeovers Code when deciding the requirements for approval of a scheme of arrangement, including the level of shareholder approval required and the information to be provided to shareholders; and

(ii) before approving a scheme of arrangement the Court receives and takes into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved.