

Policy on exemptions from the Code for schemes of arrangement effected under the Companies Act 1993

Introduction

1. The Panel is reviewing its policy regarding the use of its exemption powers to facilitate changes of control of code companies resulting from schemes of arrangement under Part XV of the Companies Act 1993 (“schemes of arrangement”).
2. The Code provides that a person may not become the holder or controller of more than 20% of the voting rights in a code company unless one of the mechanisms in rule 7 is utilised. Under rule 7 the means by which changes of control can be effected are takeover offers and acquisitions or allotments approved by non-interested shareholders. Under these mechanisms shareholders are given the opportunity to participate in or approve a change of control.
3. Any scheme of arrangement that would result in a person becoming the holder or controller of more than 20% of the voting rights of a code company comes within the scope of the fundamental rule of the Code. Sometimes such schemes will encompass the use of a Code mechanism, such as an allotment, but in other cases they will not. There is no statutory exemption from the provisions of the Code in respect of such schemes, whether or not they utilise an existing Code mechanism.
4. The Panel recognised that the application of the Code to schemes of arrangement under the Companies Act means that some mergers by way of a scheme of arrangement are unlikely to be possible without the assistance of some form of exemption from the Code. The Panel’s existing policy on exemptions for schemes, published in July 2003, is aimed at permitting mergers by way of schemes in limited circumstances, subject to conditions which provide a balance between the objectives of both the Code and the Companies Act.

5. The Panel considers that there are two areas where the policy should be revised:
 - the threshold which must be satisfied in order for an exemption to be granted; and
 - the conditions relating to shareholder approval which the Panel will be likely to impose, particularly for the purpose of protecting minority shareholders.
6. This paper sets out the Panel's proposed changes to its policy and seeks comment from market participants.
7. In addition this paper discusses the legislative framework regarding changes of control of companies and the relationship between the Code and the Companies Act in this context. We also seek market comments on this issue.

Exemption policy threshold

8. The Panel's existing published policy on schemes arrangement states that:
 - (a) If an exemption application relates to a scheme of arrangement that is for all intents and purposes a takeover, particularly one involving expulsion of minorities, then for the purposes of considering an exemption the Panel will treat the transaction as a takeover. The Panel is likely to decline such applications so that target company shareholders are not denied the benefit of the full protections of the Code; and
 - (b) it may be appropriate to provide exemptions to facilitate the use of a scheme of arrangement where there are clear and compelling reasons why the proposed transaction should not be structured as a takeover or completed using one of the mechanisms permitted under the Code.
9. Having considered a number of applications for exemption under the published policy, the Panel considers that application of the threshold provisions referred to in (a) and (b) above are not the most appropriate thresholds for the granting of an exemption.

10. Although a scheme may appear for all intents and purposes to be a takeover, there may be a number of reasons why a scheme is the best and most appropriate mechanism for a particular takeover transaction. The requirement for “clear and compelling reasons” referred to in paragraph (b) above is a difficult test to apply. It requires the Panel to assess the suitability of the mechanism that parties have chosen to use to give effect to a change of control in particular circumstances. The Panel is not comfortable in determining that issue, particularly given that a scheme is a legitimate statutory process.
11. The Panel considers that instead of applying the threshold provisions referred to in (a) and (b) above it should focus solely on how the Code applies to the particular scheme of arrangement that the parties have elected to use and consider any proposed exemption in accordance with the Panel’s guidance note *The Takeover Panel’s Exemption Power* (January 2005). As stated in the Panel’s guidance note, the Panel will in deciding whether an exemption is appropriate consider whether compliance with the Code is possible and whether compliance would create an inappropriate, unreasonable or unintended result.
12. In the context of the Panel’s approach to exemptions for schemes of arrangement it is important to note that the Panel’s policy is aimed at schemes which cannot proceed without some form of exemption. The policy is not aimed at schemes which can proceed without the benefit of an exemption. In those situations an exemption would not be consistent with the objectives of the Code and would not be granted.

Conditions of exemptions for schemes of arrangement

13. Any exemption granted by the Panel would be subject to conditions based on the objectives and mechanisms of the Code.
14. The Court generally requires that schemes of arrangement be approved by special resolutions of the merging companies at shareholder meetings. Accordingly, it is appropriate that the conditions of an exemption from the Code relate to the approval of shareholders. The conditions of any exemption will ensure that the principles of the Code are not subverted by the use of a scheme.

15. The Panel's present policy in dealing with conditions states that exemptions would generally require that the scheme is approved by:
- 75% of votes cast by those entitled (as determined by the Court) to vote and who vote at the meeting, and being more than 50% of the total voting rights of the target company (the 75/50 threshold); and
 - 50% by-number of shareholders who are entitled to vote, and who vote at the meeting, including by proxy (the 50% by-number requirement);
- unless the Panel considered that particular circumstances required different approval conditions.
16. The Panel still considers that the 75/50 threshold is appropriate. The 75% resolution reflects the typical requirement by the Court that the scheme be approved by a special resolution. The requirement that the resolution be approved by shareholders representing more than 50% of the voting rights in a code company reflects the minimum acceptance rule contained in rule 23 of the Code.
17. However, the Panel no longer intends to impose the 50% by-number requirement. Although intended to protect minority shareholders, a by-number requirement is based on a head-count of shareholders whereas the provisions of the Code relate to percentages of voting rights held or controlled by shareholders.
18. As the Panel will no longer be imposing the 50% by-number requirement, in some situations a requirement in addition to the 75/50 threshold will be needed to protect shareholders. The issue for the Panel is what such an additional requirement should be.
19. The Code, in addition to the 50% minimum acceptance rule, has two key thresholds for the protection of shareholders in relation to changes of control:

- rule 7(c) and 7(d) provide that in respect of an acquisition or allotment of shares that results in a person breaching the fundamental rule the relevant transaction must be approved by an ordinary resolution of shareholders entitled to vote and voting at a meeting. Shareholders associated with the party increasing its control percentage are not permitted to vote on such resolutions;
 - if a person becomes the holder or controller of 90% or more of the voting rights of a code company the compulsory acquisition provisions will be triggered.
20. The Panel will in future, in determining what conditions are appropriate in respect of a particular scheme of arrangement, look to these key principles. For example in a case where a scheme is in effect a compulsory acquisition the 90% compulsory acquisition threshold will be reflected in the conditions of an exemption.
21. A further example of a situation where the Panel would need to impose a requirement in addition to the 75/50 threshold is where one shareholder holds a substantial percentage of the voting rights in a code company and consequently is in a strong position to ensure that the 75/50 threshold is met. In such a situation the Panel would need to take into account the meeting provisions contained in the Code in determining an appropriate voting requirement for the meeting. This would include, in particular, conditions restricting of the ability of certain shareholders to exercise their voting rights.
22. The conditions of any exemptions for schemes of arrangement would also continue to include a requirement that shareholders be provided with adequate information about the proposed transaction equivalent to that which would have been provided under a Code offer. The Panel does not propose changing that aspect of its policy.

Relationship between the Code and the Companies Act

23. At present there are three mechanisms which can be used to effect a change of control of a company:
- The mechanisms contained in the Code;
 - The amalgamation provisions contained in Part XIII of the Companies Act; and
 - The scheme of arrangement provisions in Part XV of the Companies Act.
24. There are difficulties in the relationship between these three alternative procedures.
25. The purpose of the Panel's exemption policy for schemes of arrangement is to enable a scheme to be utilised but to impose requirements that reflect the principles of the Code. However, there is a growing trend to use and structure schemes of arrangement to avoid the necessity for an exemption and the conditions the Panel would seek to impose.
26. An example of such circumstances was the reconstruction of Independent Newspapers Limited and Sky Network Television Limited. Both companies were code companies and proposed to merge by way of a scheme of arrangement. 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. The Code prima facie applied in respect of Newco's acquisition of INL and Sky shares. In order to avoid the application of the Code to the acquisition of INL and Sky 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 two code companies.
27. This device of cancelling voting rights as part of a scheme of arrangement was utilised more recently by Wrightson Limited and Pyne Gould Guinness Limited as part of the merger of those companies by scheme of arrangement. Under that scheme the parties combined as a result of the acquisition by Pyne Gould of Wrightson shares in return for shares in that company. The Code prima facie applied in respect of the

acquisition of Wrightson shares by Pyne Gould. However, as in the INL situation, the voting rights attaching to the Wrightson shares were cancelled so that the acquisition of Wrightson shares by Pyne Gould was not caught by the fundamental rule. This left only one aspect of the transaction which was caught by the Code, the allotment of Pyne Gould shares to one shareholder of Wrightson who would as a result of that allotment hold or control more than 20% of the voting rights in Pyne Gould. A shareholders resolution was passed under rule 7(d) of the Code in respect of that allotment under the scheme.

28. In addition to schemes of arrangement being utilised to avoid the Code, they can also be used as an alternative to an amalgamation procedure under Part XIII of the Companies Act. Although the procedure for amalgamations in the Companies Act does not involve the Courts, it provides dissenting shareholders with minority buy-out rights. Parties who wish to avoid the implications of minority buy-out rights can give effect to an amalgamation under the scheme of arrangement provisions.
29. Schemes of arrangement are under the control of the Court and are subject to conditions imposed by the Courts. However, at present the Court in approving schemes of arrangement is apparently not taking into account the fact that a technical device is being used to avoid the Code, and the exemption procedure, and/or to avoid the application of the minority buy-out provisions in the Companies Act.
30. The Panel views the recent use of schemes of arrangement as avoidance mechanisms as unsatisfactory. There can be good and proper reasons to utilise the scheme of arrangement procedure but it is not appropriate for it to be used as a device to avoid key requirements of the Companies Act and the Code.

Request for comment

The Panel would like to hear from market participants as to its proposed amendments to its policy on exemptions for schemes of arrangement and the relationship between the Code and the Companies Act in respect of schemes.

Policy on exemptions for schemes of arrangement

What are your views on the Panel's proposed policy on when exemptions for schemes of arrangement will be granted as outlined in this paper? What are your views on the Panel's proposal to no longer apply the "compelling reasons" test in respect of schemes of arrangement?

Regarding conditions to which exemptions should be subject:

- *Do you consider that it is appropriate that any exemptions for schemes of arrangement will generally require that the scheme be approved by 75% of votes cast by those entitled to vote and who vote at the meeting, and being more than 50% of the total voting rights in the company?*
- *How should the conditions of any exemption protect the rights that shareholders, in particular minority shareholders, have under the Code in respect of a scheme of arrangement?*
- *Do you have any other suggestions or comments on the issues raised above?*

Relationship between the Code and the Companies Act

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?

Do you have any other suggestions or comments on the issues raised above?

Any comments should be sent to the Panel by Monday 1 May 2006.