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SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE COMPANIES

A DISCUSSION PAPER ISSUED BY THE TAKEOVERS PANEL

Introduction

The Takeovers Panel is seeking urgent public comments on possible changes that could be made to the Takeovers Code and the provisions of the Companies Act 1993 governing amalgamations and schemes of arrangement.

One of the functions of the Panel is to keep under review the law relating to takeovers of specified companies (code companies) and to make recommendations for changes to the law as appropriate. The Panel has for some time been reviewing the use of schemes of arrangement and amalgamations under the Companies Act as a means of effecting changes of control of code companies. This first led the Panel to develop a policy on exemptions for schemes of arrangement, published in July 2003. With the growth of schemes as a means of effecting changes in control of code companies since publication of that policy, the Panel has had to regularly review its policy.

Recently that on-going review had coincided with significant media and market attention on the ability of market participants to use schemes of arrangement and amalgamations to effect a merger or acquisition involving a code company in a manner that is outside of the provisions of the Code.

The Panel has been reflecting on media comments, submissions made to the Panel in response to a recent paper produced by the Panel on its policy for exemptions for schemes and on its own experience with the application of the Code. As a result the Panel has decided that it should make recommendations to the Government on what it considers are desirable changes to the law. The Panel does not wish to do this without the benefit of additional market comment on a number of specific issues raised in this paper.

Background

Some market participants have advised the Panel that they are concerned that merger transactions that have the same result as a code offer can be structured as an amalgamation or

scheme of arrangement in a manner that means the rights and protections available to shareholders under the Code do not apply. There has been some suggestion in the media that the integrity of the New Zealand market will suffer if the provisions of the Code can be avoided by adopting a mechanism to acquire a code company outside of the provisions of the Code.

Other market participants have argued that it is appropriate that companies should be free to choose between various change of control mechanisms.

In response the Panel has been reviewing the relationship between the Code and the provisions in the Companies Act relating to amalgamations and mergers.

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 are dependent upon the choice of mechanism used by parties to effect such a transaction. The Panel considers that there should be consistency as to the rights and protections for code company shareholders regardless of the form of the mechanism used to effect a merger with or acquisition of a code company.

In this paper we discuss the relationship between the Code and the reconstruction provisions of the Companies Act and possible issues arising from the use of schemes and amalgamations to effect a merger with or acquisition of a code company. We also discuss the Panel's current approach to issues arising in relation to the use of amalgamations and schemes in respect of code companies. This paper also discuses how such problems could be addressed in the form of amendments to the Code and the Companies Act.

The Panel would like to hear from the market on the issues raised in this paper and possible amendments to the Code and the Companies Act to address such issues. There is a list of questions that we would particularly like market participants to address at the end of this paper.

The Code

The Code was introduced to balance the interests of market participants in respect of changes of control of publicly traded companies.

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.

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

The Code governs changes of control of companies registered 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.

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 two main mechanisms under rule 7 which could be used to effect a change of control of a code company or the acquisition of a code company are:

- Making a code offer; and
- Seeking shareholder approval for an acquisition or allotment of shares that could result in an actual or effective change of control.

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 either the opportunity to take part in the process and share in any premium paid for control.

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:

- 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. Parties involved in the acquisition or allotment and their associates cannot participate in the vote.

- A full takeover offer must be conditional on the offeror receiving acceptances which would result in it becoming the holder or controller of more than 50% of the voting rights in the target company.

Whether a change of control is carried out by way of a transaction or allotment approved by shareholders or through an offer, securities in the code company cannot be compulsorily acquired unless the person increasing its control percentage becomes the holder or controller of 90% of the voting rights in the code company[1].

The Code requires that shareholders of the code company are provided with a document[2] from the code company which includes a recommendation on the offer, acquisition or allotment and a report from an independent adviser (approved by the Panel) on the transaction. This document is intended to provide shareholders with information to enable them to decide for themselves the merits of an offer, acquisition or allotment.

[1] 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.

[2] In the case of an offer, a target company statement, and in the case of an acquisition or allotment of shares a notice of meeting.

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

- The transaction has 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[3] becomes the holder or controller of 90% of the voting rights in the code company.

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

By contrast, the scheme and amalgamation mechanisms provided under the Companies Act permitting parties to effect a change in respect of the code company may avoid the Code do not provide the same rights and protections.

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.

Amalgamations under Part XIII of the Companies Act

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:

- the amalgamation proposal is approved by shareholders representing 75% of the voting rights voted at a meeting of shareholders of each amalgamating company; and

- 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.

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.

Neither the Code nor the Companies Act provides that the provisions of the Code do not apply to changes of control of code companies resulting from an amalgamation under Part XIII of the Companies Act.

Accordingly, if an amalgamation would result 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

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

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)[4].

In such situations, shareholders of the relevant company would in effect have two votes in respect of the amalgamation proposal:

- For the purposes of the Companies Act the amalgamation proposal would need to be approved by a resolution of 75% of shareholders voting at a meeting, with all shareholders in the code company being entitled to vote; and

- For the purposes of the Code the acquisition or allotment of shares in the code company would need to be approved by a resolution of more than 50% of shareholders entitled to vote and voting at a meeting. Parties acquiring or selling shares in the code company under the amalgamation and their associates would not be entitled to vote.

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

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 amalgamation transactions may have the same ultimate result as a code offer or acquisition they will not have any Code consequences. Since such amalgamations 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.

An amalgamation proposal will need to be approved by a resolution of shareholders of the code company but the level of shareholder approval required is different from that required in respect of code transactions.

Although an acquisition or allotment under the Code can take place with the approval of only a majority of shareholders entitled to vote and voting at a meeting, dissenting shareholders can continue to hold their shares in the code company unless a person reaches the 90% dominant owner threshold and compulsorily acquires all outstanding shares.

In respect of an amalgamation the nature of the transaction is that all shares of the amalgamating companies will be compulsorily acquired. Shareholders cannot choose to continue to hold their shares in the code company as it will cease to exist after the amalgamation. However, the threshold for this to occur is 75% of shareholders voting at a meeting. This is significantly lower that the compulsory acquisition threshold under the Code.

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.

[4] This was the case in the recent merger transactions undertaken by Wakefield Health Limited and Royston Hospital Limited. In that case 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.

This differs from the Code in that 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 is only triggered when a person becomes the holder or controller of 90% or more of the voting rights in the company.

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 Code 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 also receive information about the constitution of the amalgamated company, the minority buy-out rights and material interests of directors in the proposal.

However, there is no requirement in the Companies Act that shareholders receive a report on the merits of the proposed transaction 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.

Arrangements, amalgamations and compromises under Part XV of the Companies Act

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.

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.

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.

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.

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.

Before sanctioning a scheme of arrangement the Court commonly requires that it be satisfied of the following[5]:

[5] These matters were set out in *Re CM Bank Limited* [1944] NZLR 248

(a) There has been compliance with the statutory provisions as to meetings, resolutions, the application to the Court and the like;

(b) The scheme has been fairly put to the class or classes concerned and, if a circular or circulars have been sent out (as is usual), those circulars gave all the information reasonably necessary to enable the recipients to judge and vote upon the proposals;

(c) Each relevant class was fairly represented by those who attended the meeting and that the statutory majority were acting bona fide and were not coercing the minority in order to promote interests adverse to those of the class whom they purported to represent; and

(d) The scheme was such that an intelligent and honest person of business being a member of the class concerned, and acting in respect of his interest, might reasonably approve.

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

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.

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.

There are some circumstances in which compliance with the Code is required but is not possible in respect of a scheme. 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 objectives and mechanisms 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.

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 technical breach of the fundamental rule because no person will become the holder or controller of voting rights in the code company under the scheme.

If a scheme in respect of the 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 required for the transaction to proceed will be determined by the Court and may be different from the level of shareholder support required by the Code. It is likely that shares in the code company will in

effect be able to be compulsorily acquired with the support of the holders of less than 90% of the total voting rights in the relevant code company.

In the past two years two mergers structured as schemes of arrangement have utilised the device of cancelling voting rights attaching to shares in a code company before those shares were acquired. In one of those mergers the parties 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 of arrangement. The Panel considers that in those two cases the schemes were intentionally structured to avoid the provisions of the Code.

Panel's recent actions

Taking into account the apparent trend to effect changes of control of code companies by the use of schemes of arrangement, market reaction to that trend and the importance placed by the Panel on the availability of the protections offered by the Code when changes of control occur in code companies, the Panel recently decided that 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.

The Panel considers that it would be of assistance to the Court in its supervision of schemes of arrangement to receive submissions from the Panel on the use of the scheme procedure and the protections contained in the scheme for shareholders, particularly minority shareholders, taking into account the special legislative treatment relating to code companies contained in the Takeovers Act 1993 and the Code. The Panel has not yet made any submissions to the Court regarding proposed schemes of arrangement. It is uncertain what weight the Court will give to such submissions or indeed if the Panel would be heard.

The class exemption for initial public offers, previously contained in clause 7 of the Takeovers Code (Class Exemptions) Notice (No.2) 2001, was granted to enable new public company floats to proceed where the parties have complied with the Securities Act 1978 and some additional disclosures about control percentages to be obtained by major or cornerstone shareholders have been made in the prospectus and investment statement. The Panel considered that the use of this class exemption in schemes of arrangement was not appropriate and revoked the exemption with effect from 19 May 2006.

Relationship between the Code and reconstructions under the Companies Act - Effect of ability to choose different mechanisms for effecting a merger with or acquisition of a code company

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.

The Panel considers that it can be appropriate for there to be different mechanisms for effecting mergers or restructuring code companies. Each mechanism has its own advantages and disadvantages[6]. In different situations alternative mechanisms will be more appropriate.

Parties may be able to choose to comply with the provisions of both the Code and the Companies Act in respect of an amalgamation or scheme of arrangement. This will probably mean that shareholders will have two votes on the same transaction. In respect of a merger of a code company with a company which is not a code company, the voting thresholds and resolutions for each set of shareholders may be different.

An amalgamation or scheme structured in a manner which avoids the Code may achieve the same outcome, i.e. the merger or acquisition of a code company, as a code transaction. However shareholders of the relevant code company will have different rights and protections than if the transaction was undertaken within the jurisdiction of the Code.

Most amalgamations and schemes of arrangement involve what is in effect a compulsory acquisition. The shares held by shareholders in a company are all cancelled in exchange for consideration, either in the form of cash or securities issued by another entity. However, this form of compulsory acquisition can occur with a significantly lower level of shareholder support than a compulsory acquisition following a code transaction.

In order for a person to compulsorily acquire shares under the Code that person has to become the holder or controller of 90% or more of the total issued voting rights in the code company. As discussed above, an amalgamation proposal requires the approval of 75% of shareholders entitled to vote and voting at a meeting. Schemes of arrangement usually have the same approval threshold.

Even if an amalgamation or scheme is not characterised as a compulsory acquisition, the threshold for approval of the transaction is very different from the threshold for Code acquisitions and allotments and may not offer the same level of protection to minority shareholders.

The resolution required to approve an amalgamation, and in most cases a scheme of arrangement, is a resolution representing 75% of the voting rights of shareholders who cast a vote at a meeting of shareholders (although a separate approval from an interest group may be required). No shareholders are excluded from voting on the resolution. Accordingly a major shareholder of the code company may be able to pass a resolution approving an amalgamation or scheme with little or no support from other shareholders, depending on the number of shareholders who exercise their votes on such a transaction.

An amalgamation or a scheme of arrangement would also differ from a code transaction in respect of the information provided to shareholders in respect of the proposed transaction. 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 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. In respect of a scheme or amalgamation outside of the Code, shareholders receive a document prepared for all of the merging entities

[6] There may be different tax and other consequences resulting from the mechanism used

and not tailored specifically to code company shareholders. It may contain an independent appraisal report if required by the listing rules but the Panel would have no involvement in the appointment of this adviser or its report.

Market comment

The issue on which the Panel wants to receive feedback from market participants is - *whether it is 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?*

The Panel received some comments from market participants on this issue in response to its recent consultation paper on its proposed policy on exemptions for schemes of arrangement[7]. Some market participants also made comments to the Panel concerning the recent amalgamation of Waste Management New Zealand Limited, a code company, with Transpacific Industries Group Limited.

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, 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 consider 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.

However, a number of other market participants, including brokers and shareholders, have said that they cannot understand why a transaction which looks like a takeover and has the same effect as a takeover can be carried out under the amalgamation or scheme provisions under the Companies Act. These market participants referred to the recent amalgamation proposal involving Waste Management, and expressed the view that under that transaction 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.

Some media commentators and market participants have suggested that the Code is weak if it can be avoided easily by structuring a transaction as an amalgamation or a scheme. They have 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.

It has been suggested that the ability to use an amalgamation or a scheme to avoid the Code is a loophole in the Code and if this loophole is not addressed the integrity of the New Zealand

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[7] *Policy on exemptions from the Code for schemes of arrangement effected under the Companies Act 1993*, 4 April 2006, available on the Panel's website

market and the confidence of the investors, both domestic and international, in that market will suffer.

While most submissions recognised the need for an alternative transaction structure to a code offer to be available in some circumstances, a number of submissions expressed 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. The majority of market participants who have contacted the Panel in respect of the use of amalgamations and schemes desire 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.

Panel comment

The Panel has been considering these comments. The Panel has similar concerns to those of many market participants.

We note that when the Takeovers Act was introduced the legislature decided that in respect of a certain class of companies, code companies, there should be certain restrictions on the mechanisms for changes of control in order to ensure all shareholders have an opportunity to participate in such changes of control in a consistent and fair manner.

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 certain transactions involving changes of control. This intention is demonstrated by rule 5 of the Code which states that parties cannot contract out of the Code and because there were no statutory exceptions from the Code for schemes of arrangement and amalgamations.

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.

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 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.

However, the current relationship between the Code and the reconstruction provisions of the Companies Act means that, in the context of a change of control, the rights and protections available to code company shareholders are determined by the form of a transaction rather than its substance.

The Panel does not believe that all changes of control of code companies must utilise one of the code mechanisms.

The Panel considers that it would be inappropriate to limit the ability of parties to choose and utilise different reconstruction mechanisms or to require that changes of control of code companies be effected by the use of a code mechanism only. The Panel recognises that there

are a number of legitimate reasons why parties may choose to structure a transaction as a scheme or amalgamation rather than as a takeover.

Nonetheless, the Panel's preliminary view is that all reconstruction mechanisms which effect a change in control (whether by way of a merger with or acquisition of a code company), should provide shareholders with comparable rights and protections in respect of each such transaction.

We note that in the last two years two companies have utilised the device of cancelling voting rights under a scheme in order to effect a merger transaction and avoid the application of the Code. There has been at least one amalgamation of a code company outside of the jurisdiction of the Code.

The Panel has taken some initial steps to protect the interests of shareholders and the market.

In respect of future proposed schemes of arrangement the Panel has stated that it will seek to make submissions to the High Court regarding the principles of the Code and the rights and protection which shareholders of the relevant code company would have if a scheme was not structured in a manner that avoided the jurisdiction of the Code.

However, this may not be an effective solution to the problems which some market participants have urged the Panel to address.

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 made any submissions to the Court regarding proposed schemes of arrangement. It is uncertain what weight the Courts will give to such submissions or indeed if they will hear the Panel.

In addition, the Panel has no ability to influence the process surrounding amalgamations involving code companies which are framed in such a way that they are outside the jurisdiction of the Code.

Under the current legislative framework of the Code and the reconstruction provisions of the Companies Act, the Panel can take no other action in respect of amalgamations or schemes of arrangement involving code companies which are structured outside of the Code.

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.

Subject to the comments received on this paper, the Panel intends to make recommendations to the Government for some form of amendment to the law to address the issue of consistency of shareholder rights and protections in respect of mergers with and acquisitions of code companies.

In considering what may be an appropriate approach regarding these issues it is useful to look to overseas experience. 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.

Schemes of Arrangement in Australia and the United Kingdom

We note that in Australia and the United Kingdom schemes of arrangement are recognised as an important mechanism for effecting changes of control. However, in both of those jurisdictions it is a requirement that a scheme does not offend the takeovers regime.

In the United Kingdom a scheme is considered an offer for the purposes of the City Code and a scheme must comply with many of the requirements of the City Code.

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.

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.

The Eggleston Principles are the objectives of Chapter 6 of the Corporations Act. These objectives 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.

Possible amendments to the Code and the Companies Act

The Panel believes that ensuring 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, while preserving the rights of companies to choose which means of changing control they use, 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 and amalgamations.

We discuss this approach separately in respect of schemes of arrangement and amalgamations.

Schemes of arrangement

In respect of schemes of arrangement a similar approach to that taken in Australia could be utilised in New Zealand. 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, those Acts 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 (with the definition of control being sufficiently broad to ensure that the alternative protections are not also avoided); and

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

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

(ii) 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.

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 intended relationship between schemes of arrangement and the Code which they do not currently have.

The Panel considers 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 rather than the objectives of the Code.

By considering the principles of the Code the Courts could apply the broader principles of the Code of equal treatment and fairness in the particular circumstances of the proposed scheme to ensure that the rights of shareholders of code companies are not detrimentally affected by the form of mechanism used to effect a change of control.

A provision for the Panel to provide recommendations would ensure that the Court in considering an application for approval of a scheme would have more balanced information before it than we suspect is currently the case.

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.

The Panel would like to hear from market participants regarding the possible amendments to the Code and Companies Act described above. Would such amendments address concerns that 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?

The benefits of any possible amendment to the Code and Part XV of the Companies Act will need to be balanced against the costs of such amendments.

We suggest 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. We suggest that the level of disclosure to shareholders would be similar even though the information provided would be different. We suggest 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.

Any increases in direct costs and/or compliance costs may be mitigated by the fact that as a result of such proposed amendment 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.

The Panel would like to hear from market participants on possible compliance costs resulting from the type of amendment to the Code and Part XV of the Companies Act described above.

Amalgamations

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.

We suggest that the Panel's approval of an amalgamation process would be subject to conditions based on the principles of the Code.

We would not suggest that in approving an amalgamation process the Panel 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. In considering appropriate thresholds in respect of amalgamations the Panel would be able to take into account the minority buy-out rights currently available to dissenting shareholders and the compulsory acquisition provisions of the Code.

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.

Do market participants consider that an amendment of this type would be appropriate?

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

The minority buy-out right 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.

Under the Code if a person becomes the dominant owner of a code company as a result of an acquisition or allotment approved by shareholders and then wishes to compulsorily acquire the remaining shares, the consideration paid to compulsorily acquire shares must be certified as fair and reasonable by an independent adviser approved by the Panel. A further

independent expert may be appointed to determine the compulsory acquisition price if a specified level of outstanding shareholders object to the price being paid.

Under the minority buy-out provisions of the Companies Act, the company will nominate a fair and reasonable value for the shares and shareholders can object to that price. The company must then refer the matter to arbitration. However, shareholders do not have an independent certification as to the initial price to assist them in determining whether or not to object to the price. As already mentioned these provisions only apply to those shareholders who actually voted against the amalgamation.

The Panel would like to hear from market participants regarding the minority buy-out right for dissenting shareholders contained in the Companies Act for code companies. Do market participants 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?

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.

These potential compliance costs would need to be weighed against the benefits to code company shareholders of ensuring that they have comparable rights and protections in respect of amalgamation proposals to those provided in the Code.

The Panel would like to hear from market participants on possible compliance costs resulting from the type of amendment to the Code and Part XIII of the Companies Act described above.

REQUEST FOR COMMENTS ON THIS PAPER

The Panel invites submissions on the issues raised in this paper and the possible amendments to the Code and the Companies Act discussed in this paper.

The closing date for submissions is 30 June 2006.

Submissions should be sent to the Takeovers Panel—

- By post - Takeovers Panel
  Level 8 Unisys House,
  56 The Terrace,
  P.O. Box 1171,
  WELLINGTON;

- By fax - +64 4 471 4619; or

- By email - takeovers.panel@takeovers.govt.nz

- Electronically via the Panel's website

  - www.takeovers.govt.nz

Any submissions received are subject to the Official Information 1982. The Panel may make submissions available upon request under that Act. If any submitter wishes any information in a submission to be withheld, the submission should contain an appropriate request (together with a clear identification of the relevant information and the reasons for the request). Any such request will be considered in accordance with the Official Information 1982.

In particular the Panel would like market participants to consider and respond to the following questions:

1. *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?*

2. *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

3. *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?

4. *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?*

Schemes of arrangement

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

6. *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?*

7. *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?*

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

Amalgamations

9. *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?*

10. *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?*

11. *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?*

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

Other matters

13. Do you have any other suggestions or comments on the issues raised in the Panel's paper?