REGULATORY IMPACT STATEMENT

SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE COMPANIES

1. EXECUTIVE SUMMARY

1. In a takeover involving a Code company, bidders can circumvent the Takeovers Code by using the reconstruction provisions in the Companies Act (i.e., amalgamations under Part 13 or Court approved schemes of arrangement under Part 15).

2. It is proposed to amend the Companies Act to permit the use of a Part 15 scheme for effecting a change in control of a Code company only if the Court is satisfied the scheme does not disadvantage shareholders (when compared to a Code takeover), or if the Panel has provided a 'no-objection' statement. Shareholder approval thresholds are created and the use of Part 13 is banned for Code companies. These changes better align the Companies Act with the Takeovers Act, while retaining the flexibility of using the Part 15 provisions in the Companies Act, and improving fairness for shareholders, legal certainty, and market integrity.

2. ADEQUACY STATEMENT

3. This statement was reviewed by the Takeovers Panel and is considered adequate according to the adequacy criteria.

3. STATUS QUO AND PROBLEM

4. The Code regulates changes in the control of more than 20% of the voting rights of Code companies. Code Companies are those that have voting securities listed with a registered exchange, or have 50 or more shareholders.

5. The reconstruction provisions of the Companies Act, in Parts 13 and 15, provide mechanisms which can also be used to effect such changes of control.

6. An amalgamation under Part 13 of the Companies Act involving a Code company may be structured so that the Takeovers Code does not apply, by ensuring that no voting rights in a Code company are acquired. Recent examples include the amalgamations of Waste Management New Zealand Limited and Transpacific Industries Group, and of Humanware Limited and Jolimont Capital. Dubai Aerospace Enterprise had proposed an amalgamation with Auckland International Airport Limited (AIAL). The Canada Pension Plan also proposed an amalgamation with AIAL if its takeover offer for AIAL was successful.

7. A scheme under Part 15 of the Companies Act can also avoid the Takeovers Code if it is structured so that no person becomes the holder or controller of voting rights in a Code company. The first example of this was the merger in 2005 of Independent Newspapers Limited and Sky Network Television Limited through a new company.

8. In addition to the Takeovers Code's requirements, listed Code companies also have to comply with the Securities Markets Act's continuous disclosure requirements. The

Securities Act's prospectus and investment statement requirements also have to be complied with if bidders offer securities under a takeover offer.

9. The following table compares the key features of the Status Quo.

Table 1. Current procedures regulating takeovers and reconstructions

	Takeovers Code	Amalgamations - Part 13	Schemes – Part 15
Shareholder support:	Full takeover offer needs acceptance by over 50% of total voting rights in target company. A shareholders vote excludes the buyers/sellers and their associates. The higher the level of control sought, the higher the effective voting threshold.	75% approval by those present (or by proxy) at shareholders' meeting and entitled to vote. No minimum % of total voting rights required for approval. If either company is listed, related parties can't vote.	75% approval by those present (or by proxy) at a shareholders' meeting and entitled to vote. No minimum % of total voting rights required. Court must be satisfied of compliance with statute. Panel seeks to be heard by Court and can make submissions.
Compulsory acquisition	Shareholder reaches 90% or more of voting rights. The Code sets out how the compulsory sale price will be determined.	If approved by 75% of those present (or by proxy) and entitled to vote. No minimum % of voting rights required. No rules on sale price.	If approved by 75% of those present (or by proxy) and entitled to vote. No minimum % of voting rights required. No rules on sale price.
Shareholder Information:	Prescribed information, including an independent adviser's report.	Information not prescribed but must 'enable a reasonable shareholder to understand the nature and implications' of proposal. No independent adviser's report required (except for listed companies).	Information not prescribed but must give all information reasonably necessary to enable the recipients to judge and vote upon the proposal. No independent adviser's report required.
Enforcement:	Panel actively monitors takeover activity. Panel makes temporary restraining orders and permanent compliance orders on its own initiative or following complaints. Low cost and easy access for complainants. Panel may recover costs from a complainant if no breach is found. Those found in breach pay Panel's costs.	Shareholders can apply to the High Court to prevent an amalgamation. Companies Office reviews compliance with Part 13 requirements on filing of approved amalgamation documents. Shareholders can complain to MED of a Companies Act breach and MED may prosecute. This can result in penalties, but would not halt or amend an amalgamation.	No routine monitoring of compliance by any regulatory agency. High Court approves arrangements, amalgamations and compromises under s 236. Shareholders can take Court action or complain to the MED National Enforcement Unit in case of breaches.
Process costs and timeliness:	Bidder gives takeover notice to target 2 weeks before sending offer to shareholders. Needs separate independent adviser certification if more than one class of securities. Target prepares target company statement and sends to shareholders, with independent adviser report on merits of offer.	As proposals must be approved by boards of amalgamating companies, negotiations precede any proposal being put to shareholders. Proposal to be sent to each shareholder not less than 20 days before takes effect, give public notice, hold a shareholders' meeting, directors' certification, and register the documents.	As proposals must be approved by boards of the applicant companies, negotiations precede any application to the Court. Involves appearances at hearings for initial orders and for final orders, provide scheme proposal to Court, hold a shareholders' meeting, deliver Court order to the Registrar within 10 working days.

10. A takeover involving a Code company can be structured to use the Companies Act instead of the Takeovers Code.

11. The *outcome* of an amalgamation or scheme could be the same as a Code compliant takeover offer, and their use can lead to a more certain outcome for the bidder. But the Code provides for a fairer *process*, because, unlike under the Code, under the Companies Act reconstruction provisions:

    (a) shareholder approval thresholds are lower, and shares can be compulsorily acquired at a significantly lower approval threshold

    (b) shareholders may receive inferior information on a proposal

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

    (d) there are no constraints on the consideration and terms of the offer, whereas under the Code they must be the same for all shareholders regardless of size of shareholding

    (e) aggrieved parties may face legal and Court costs when pursuing complaints, whereas the Code provides for a low cost complaints mechanism.

12. Use of the reconstruction provisions may also not be consistent with the intent of the takeovers legislation, as the Code provides that parties cannot choose to contract out of the Code and the Panel can only grant exemptions from compliance with the Code if that is consistent with the objectives of the Code.

13. Potential costs arising from the ability to circumvent the Code are that it may:

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

    (b) raise the risk premium for investing in New Zealand, discounting share values

    (c) generate waste, as companies spend resources on structuring transactions to enable avoidance of the Code, rather than on productive activity

    (d) result in a pressured situation where shareholders may make decisions they later regret

    (e) result in a lower share price, as reduced competition in friendly ‘takeovers’ essentially forecloses other offers

    (f) result in unequal consideration for some shareholders.

14. There is no New Zealand evidence to validate these potential effects or their significance. However, there is a perception amongst shareholders, and reported in the media, that they are disadvantaged when the Code is avoided.

15. The Code covers approximately 135 NZSX and NZAX Code companies plus *at least* 218 (but probably several hundred more) unlisted companies with 50 or more shareholders, out of a total of 474,000 registered companies.

16. Between 1 July 2001 and 30 November 2007 the Takeovers Panel recorded a total of 97 takeover offers, granted two exemptions from the Code for schemes under the Companies Act, and became aware of four amalgamations or schemes that might have been used deliberately instead of the Code (as well as a number of proposals).

17. The use of the reconstruction provisions instead of the Code began in 2005. Since then it has comprised, roughly, around 14% of Code company takeovers, so it is small but not insignificant. There is no consensus whether the use of the reconstruction provisions might become more frequent. There is a risk that it will. Adverse impacts would be disproportionate because Code companies tend to be substantial, so that changes in control are high profile and can affect many shareholders.

4. OBJECTIVES

18. Table 2 outlines the objectives in section 20 of the Takeovers Act which were used to make an assessment of regulatory options.

Table 2. Policy objectives

Objectives in s.20 of Takeovers Act	Requires…
1. Encouraging the efficient allocation of resources	• An informed market with many buyers and sellers, clear property rights, and minimum barriers to trade.
2. Encouraging competition for the control of specified companies (i.e., Code companies)	• No barriers to entry or exit and low transaction costs.
3. Assisting in ensuring that the holders of securities in a takeover are treated fairly	• Equal opportunities to participate in a change of control. • Equivalent consideration for shares. • Appropriate shareholder support thresholds. • No compulsory taking of shares except for very good reason.
4. Promoting the international competitiveness of New Zealand's capital markets	• Reducing transaction costs and risk perceptions through encouraging confidence in the integrity of the New Zealand market.
5. Recognising that the holders of securities must ultimately decide for themselves the merits of a takeover offer	• Individual shareholders having access to adequate information and being given sufficient time to consider a takeover offer.
6. Maintaining a proper relation between the costs of compliance with the Code and the benefits resulting from its existence	• Knowledge of the costs and benefits.

5. ALTERNATIVE OPTIONS

19. Five principal alternatives to the status quo were canvassed in the Takeovers Panel's 2007 discussion paper. These are briefly described here. Table 3 provides a summary.

Option 1: Anti-avoidance provisions inserted into reconstruction provisions

20. The Companies Act would be amended to permit the use of the reconstruction provisions for changing control of voting rights in Code companies only if the Panel provided a 'no-objection' statement. The shareholder voting threshold would be approval by 75% of the votes of those voting and 50% of total voting rights. Shareholders with different interests would be constituted as separate classes and vote separately, as is the current common law position. This approach is similar to that in Australia.

21. The responsibilities of the Ministry of Economic Development and the Panel would be expanded to allow complaints about reconstructions to be investigated, particularly where Code companies are involved.

Option 2: Statutory exemption from Code

22. The Takeovers Act and the Code would be amended to exempt schemes and amalgamations involving a Code company from the Code. The Companies Act would also be amended as above for Option 1.

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

23. The reconstruction provisions of the Companies Act would be amended so that shareholder approval thresholds in respect of schemes and amalgamations are specified in the Companies Act and consistent with the Code, where Code companies are involved, for similar changes of control. The information requirements would also be aligned with the Code for proposals involving a Code company.

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

24. The Companies Act would be amended so that Part 13 amalgamations cannot be undertaken if a Code company is involved. The Companies Act would also be amended as above for Option 1.

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

25. The Companies Act would be amended so that neither amalgamations nor schemes of arrangement under Parts 13 or 15 of the Companies Act could be used with Code companies, except with the permission of the Panel.

Table 3. Summary assessment of the options vs. Status Quo					
Policy Objectives	**1. 'Anti-avoid-ance of Code' provision in Companies Act**	**2. Exempt from Code + Option 1**	**3. Align Companies Act with Code thresholds**	**4. No Part 13 Amalgamations + Option 1**	**5. No Part 13/15 for Code Companies**
Efficient allocation	Panel role in Court should improve information.	Panel role in Court should improve information. Provides greater legal certainty.	Little effect. Should improve information.	Firms can use Part 15. Panel role in Court may improve information	Would stop or discourage some efficiency improving reconstructions.
Competition for control	Potential deterioration, as may raise entry barriers and transaction costs to address requirements.	Potential marginal improvement as legal certainty could encourage greater use of reconstruction provisions.	Marginal deterioration if requirements to change control are made slightly more onerous.	Marginal deterioration as it removes a potentially less onerous route under which to change control.	Marginal deterioration as it removes potentially less onerous routes for changes in corporate control.
Fair treatment	Potential improvement if Panel activism results in equivalent consideration and higher voting thresholds.	As for Option 1.	Potential improvement if threshold and/or information changes improve participation.	Marginal improvement, as it raises the test for compulsory acquisitions (i.e., must use either Code or Option 1 scheme).	Improvement as all takeover proposals involving Code companies would be subject to Code (except with Panel's permission).
International competitive capital markets	Unclear. Potential improvement if Court involvement by Panel improves the perception of market integrity, but may raise transaction costs; however, closer alignment with Australian requirements.	As for Option 1	Unclear. Possible improvement if changes perception of uncertainty or other negatives. But could increase transaction costs by raising process requirements.	Unclear. Reduces uncertainty somewhat but at the same time it may raise the transaction costs of participating in takeovers.	Unclear. Reduces risk perception but at the same time it may raise the transaction costs of participating in takeovers.
Autonomous decisions	Potential improvement, as it results in higher voting thresholds under reconstructions.	As for Option 1.	Improvement through changes in voting thresholds when Code companies are involved.	Potential improvement by doing amalgamations under Part 15 provisions.	Improvement through Code applying (unless Panel permits use of reconstruction provisions).
Reasonable compliance cost	Increased Court involvement by Panel raises direct costs for bidders and the Panel. Potential increased enforcement by MED raises costs.	Increased Court involvement by Panel raises direct costs for bidders and Panel. Potential increased enforcement by MED raises costs.	Possible increases if process is more expensive.	Potential for increased costs as any switch of forums (to Code or Scheme) increases costs for the Panel.	May increase costs if switch from reconstruction provisions to Code increases Panel activity.

6. PREFERRED OPTION

26. The Panel's preferred option is a combination, with modifications, of options 1, 2 and 4 above. It is to amend the Companies Act 1993 to:

    (a) require for the use of the Part 15 scheme provisions, where voting rights in a Code company are affected, that the Court be satisfied that a scheme (rather than a takeover under the Code) would not adversely affect shareholders, or that the Panel provides a "no-objection" statement

    (b) stipulate shareholder approval thresholds so that for the resolution to be passed shareholders voting in favour of the scheme represent:

    - 75% of the votes cast at each meeting of each group of shareholders determined as being an interest class for the purposes of voting
    - more than 50% of total voting rights of the company

    (c) codify the common law principles for determining shareholder interest classes

    (d) ban use of the Companies Act Part 13 section 221 amalgamation where a Code company is involved, but allow section 222 amalgamations related to reorganisations of wholly owned subsidiaries.

27. The Takeovers Act and the Code would also need to be amended to provide a statutory exemption from the application of the Code where Code companies are involved in a scheme under Part 15 of the Companies Act if the Panel has provided a 'no objection' statement for producing to the Court.

28. This option is preferred over the status quo and other options because it aligns the Companies Act and the Takeovers Act while retaining the flexibility of being able to use Part 15 for changes of control, and improving the voting requirements. The changes would not affect reconstructions where no Code companies are involved. For giving a no objection statement, the Panel would ensure that information for shareholders was balanced by requiring advice from an independent adviser on the merits of the proposal to be given to shareholders. Key benefits are procedural fairness, greater legal certainty, and assurance of market integrity. The option is also closely aligned with relevant Australian law, which is reported to work well.

29. The costs to bidders of this option come from raising the bar for those seeking control of Code companies. First, acquirers seeking to use Part 15 would now need to gain a 'no objection' statement from the Panel. Given existing information requirements under Part 15 and the Listing Rules, additional cost for bidders is likely to be negligible. The costs to the Government could be in the order of approximately [$X] for set up costs (e.g., preparation of policies and procedures for the Panel and the market) with ongoing costs of approximately [$X] per annum (e.g., for non-chargeable time relating to review of scheme proposals, administration costs etc).

30. Second, the loss of the chance of an amalgamation under Part 13 involving Code companies may mean foregoing worthwhile amalgamations that would not be approved by the Court if done as a Part 15 scheme. However, Code takeovers remain available and amalgamations are still possible under Part 15. Thus far, there has been little use of amalgamations (despite avoiding the cost of interaction with the Panel or Court). The potential loss relates to those proposals that would only go ahead under Part 13. The risk and total cost of loss of this provision is therefore likely to be small.

31. Third, the stipulation of shareholder voting approval thresholds, and for voting in interest classes, could raise the approval hurdle significantly. Submitters have argued that it can be difficult to achieve a turnout of over 50% of total voting rights. Raising the bar in this way could thus prevent schemes that are value-adding to shareholders. However, the risk is small because the provisions are used infrequently, and there are means (awareness-raising publicity) to raise voter turnout.

32. To minimise compliance costs the Panel will develop guidance on criteria used for giving 'no objection' statements and the process for obtaining them.

7. IMPLEMENTATION AND REVIEW

33. The Panel will inform the market of policy changes through its periodic publication *Code Word*. The Panel will develop and publish on its website the policies, procedures, and information about fees, for applying for a 'no objection' statement.

34. The Panel will monitor the effectiveness and any unintended consequences of the policy through its role in evaluating Part 15 schemes. In addition, the Panel will continue to seek feedback from the market on the way it performs its functions and duties. The Panel has a statutory function to keep under review the law relating to takeovers of Code companies.

8. CONSULTATION

35. Stakeholders have had an opportunity to comment on discussion papers published by the Panel in June 2006, and December 2007. 16 submissions on the latest paper were received by February 2008 – seven from major law firms in New Zealand, three from financial service providers, and submissions from an investment bank, an independent advisor, an investor, the NZ Shareholders Association, the NZX, and the NZ Law Society.

36. Submitters were divided over the need for change; about half of the submitters preferred that the status quo be maintained. Law firms primarily did not believe there is a problem that needs fixing. Beliefs about the extent of risk to market integrity were also mixed, as were beliefs over whether information provided to shareholders was materially different under the Code or reconstruction provisions. Only one submitter gave costs estimates on compliance costs under different options; this seemed to indicate, and other submitters stated, that costs were affected primarily by the complexity of the transaction, rather than the legal vehicle chosen. Several submitters indicated that, if option 1 were chosen, clear identification of interest classes would be necessary. This has been reflected in the preferred option.