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25 August 2006

**SUBMISSION TO THE COMMERCE COMMITTEE ON THE BUSINESS LAW
REFORM BILL**

**SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE
COMPANIES**

This submission is made by the Takeovers Panel, a Crown entity established by the Takeovers Act 1993.

One of the functions of the Panel is to keep the law relating to takeovers of specific companies under review and it is under this function that the Panel wishes to make a submission to the Commerce Committee on the Business Law Reform Bill as it relates to the Companies Act 1993.

Summary

We have no comments on the current contents of the Business Law Reform Bill. The purpose of our submission is to request that the Bill also include amendments to Part XIII of the Companies Act, which relates to amalgamations, and Part XV of the Companies Act, which relates to schemes of arrangement. We suggest that such further amendments are appropriate to address problems arising from the relationship between Parts XIII and XV of the Companies Act and the Takeovers Code.

Relevance of submission

The Business Law Reform Bill is aimed at improving business laws by revising certain statutes. We note that the general policy statement in the Bill states that the amendments contained within it:

- Clarify and update various statutory provisions to give effect to the intended purpose of the provisions; and
- Remove unnecessary compliance costs, and
- Remove conflicts within and between legislation.

The Bill contains certain amendments to the Companies Act 1993. We submit there are other matters in that Act which require amendment in order to give effect to the intended purposes of certain legislative provisions and remove conflicts between certain provisions of the Companies Act and the Takeovers Code, enacted under the Takeovers Act 1993.

Relationship between the Companies Act and the Takeovers Code

Companies can use the provisions of the Companies Act relating to amalgamations and schemes of arrangement to effect mergers with, or acquisitions of, other companies. The Companies Act contains certain requirements in order for amalgamations or schemes to proceed. In respect of an amalgamation the proposed transaction must be approved by the boards of the relevant companies and by a special resolution of shareholders, which is 75% of shareholders who vote at a meeting. In respect of a scheme the process for approval is set down by the High Court following an application from the relevant companies. The Court generally requires that schemes are approved by a special resolution of shareholders.

The Panel has become aware that parties have been utilising the amalgamation and scheme provisions of the Companies Act as devices to avoid the provisions of the Takeovers Code. The Panel considers that the ability to use amalgamations and schemes in this way is a loophole in the current law which needs to be addressed.

The Takeovers Code provides special protections and rights to shareholders of specified companies (code companies) in respect of transactions resulting in a change of control of those companies. The Takeovers Code was intended to apply to all changes of control of code companies irrespective of the particular manner in which the change occurs. The principle provisions of the Code can be summarised as follows:

- The Code is based upon a 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%, that person's control percentage cannot be further increased except as permitted by the Code.
- The mechanisms which a person can utilise to increase its percentage of voting rights in a code company are based upon the principles of equal treatment and equal participation. The main mechanism under the Takeovers Code to effect a change of control of a code company is a takeover offer under the Code. 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.
- Apart from the 20% threshold in the fundamental rule there are two key thresholds in the Code:
 - A takeover offer must be conditional on the offeror achieving control of more than 50% of the voting rights in the code company. A person who holds or controls more than 50% of voting rights can also exercise annual creep rights of 5%;

- If a person becomes the holder or controller of at least 90% of the voting rights in a code company, the compulsory acquisition provisions of the Code apply.
- Code company shareholders must be provided with information to enable them to decide for themselves the merits of an offer or transaction. An important part of that information is a report on the merits of an offer prepared for code company shareholders by an independent adviser.
- In respect of a shareholder vote on a proposed acquisition or allotment of shares in a code company the parties to the proposed transaction and their associates are not permitted to vote.

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 an amalgamation or scheme under the Companies Act and avoid the jurisdiction of the Takeovers Code.

Structuring a transaction as an amalgamation or scheme outside of the Takeovers Code means that the protections for shareholders contained in the Takeovers Code will not be available to code company shareholders even though the transaction has the same effect as a takeover under the Code.

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.

An example of an amalgamation which avoided the jurisdiction of the Takeovers Code 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. The amalgamation was passed by a special resolution but the resolution was supported by the holders of less than 50% of the voting rights in Waste Management.

A scheme of arrangement which avoided the jurisdiction of the Takeovers Code 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 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. It is not the intention of the Takeovers 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 to effect the change 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.

The Panel does however acknowledge that in some circumstances a scheme or an amalgamation is the most appropriate way to structure a transaction. Consequently rather than prohibit the use of schemes and amalgamations effecting changes of control of code companies, the Panel considers that it would be appropriate for the principles of the Takeovers Code, and the type of protections provided by the Code, to be introduced into the requirements for amalgamations and schemes involving code companies.

The Panel is 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. 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.

Recommended amendments to the Companies Act

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.

To achieve this, the Panel considers that the Takeovers Code and Companies Act should be amended so that:

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

Specifically, the Panel recommends that:

- (a) 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

- (b) 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.

Consequently, 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.

In respect of the recommended amendment to Part XIII of the Companies Act, the Panel suggests that the approval of an amalgamation process be subject to conditions based on the principles of the Code. However, the Panel would not always seek to impose identical requirements to those contained in the Code as these may not be appropriate in every situation, particularly as amalgamations involve a meeting procedure and not an offer to each individual shareholder. The Panel would take into account the principles of the Code including the thresholds and the information requirements specified in the Code. The Code was based around ensuring participation by all shareholders in changes of control, fairness and equal treatment, and the provision of the information required to enable shareholders to make an informed decision.

The suggested amendment to Part XV would not require the Court to follow or implement the recommendation of the Panel. However, provision for the Panel to provide recommendations would assist the Court in fulfilling the obligation proposed in the amendment to take into account the principles of the Code. The Panel's recommendations would be based on the principles of the Code as mentioned above in relation to amalgamations.

The amendments to the Companies Act suggested by the Panel would enable the intention of the Takeovers Code to be fulfilled while preserving the rights of companies to use the reconstruction mechanisms provided in the Companies Act.

The Panel considers that amendments to the Takeovers Code and the Companies Act are appropriate and necessary to address a loophole in the current law which allows parties to use the amalgamation and scheme provisions as a device to avoid the provisions of the Takeovers Code.

The Panel asks the Commerce Committee to consider including the amendments to Part XIII and Part XV of the Companies Act described above in the Business and Law Reform Bill.

The Panel has also recommended the amendments described above to the Minister of Commerce.

Further information in support of the Panel's submission

The Panel decided to make this submission to the Commerce Committee and the recommendation to the Minister of Commerce 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.

The Panel's paper to the Minister in respect of its recommendations is attached. The paper to the Minister sets out the issues regarding the use of amalgamations and schemes in respect of code companies, matters which the Panel has taken into account in reaching its view and details of the process that the Panel has followed in considering this issue.

Request to appear before the Commerce Committee

We would like to appear before the Commerce Committee to speak to our submission. The individuals who wish to appear are:

Mr John King, Chairman of the Takeovers Panel
Mr David Jones, Deputy Chairman of the Takeovers Panel
Mr Kerry Morrell, Senior Executive Officer
Ms Marion Hemphill, Counsel to the Takeovers Panel.

Please contact Marion Hemphill (DDI 471 4611, marion.hemphill@takeovers.govt.nz) if you require further information in the meantime.

Yours faithfully

A handwritten signature in black ink, appearing to read 'John King', with a horizontal line underneath it.

John King
Chairman
Takeovers Panel