

The Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

TAKEOVERS - SCHEMES OF ARRANGEMENT, AMALGAMATIONS, AND CODE COMPANIES

PROPOSAL

- 1 This paper recommends that Cabinet agree to amendments to the Companies Act 1993. These amendments will ensure that changes of company control that take place under the Companies Act are consistent with the procedures for changing control of companies under the Takeovers Code.

EXECUTIVE SUMMARY

- 2 Concerns have been raised by market participants, and shared by the Takeovers Panel ("the Panel"), about a loophole which essentially allows companies to take over another company using the reconstruction provisions (Part 13 amalgamations, and Part 15 schemes of arrangements) of the Companies Act 1993 (the "Companies Act") rather than the Takeovers Code (the "Code").
- 3 The Code was developed by the Takeovers Panel under the Takeovers Act 1993 (the "Takeovers Act") and came into effect in 2000. Its two main objectives were to align New Zealand's takeovers regime with international best practice - giving international and domestic investors greater confidence in our market; and to give greater confidence to small and minority shareholders by providing them with fair and equal treatment and participation in takeover situations.
- 4 There are several consequences of a takeover for the shareholders of a target company. The change of control could affect the overall strategy of the company and the value of its shares. A shareholder's shares can also be compulsorily acquired. Overall, a takeover can have a material impact on shareholders' existing property rights.
- 5 The effect of using the Companies Act provisions rather than the Code is that takeovers can be undertaken with less information provided to shareholders and with a lower level of shareholder participation or support (and, in the case of amalgamations, with a lower level of regulatory oversight by the Court or Panel). The existence and use of the Companies Act loophole undermines the underlying intent of the takeovers regime. Over time, the loophole could undermine domestic and international perceptions of the integrity of New Zealand's takeovers market, and may impair market confidence.

- 6 The Panel has provided the government with advice on this issue following a process of public consultation. It received sixteen submissions from representatives of interest groups involved in takeovers matters, including the New Zealand Shareholders Association, the New Zealand Law Society and seven major law firms. Submissions were divided over the need for change, and about half of the submitters preferred that the status quo be maintained because of the flexibility for promoters¹ of takeover transactions under the current arrangements. Those who preferred the status quo all represented potential scheme promoters' interests, while those who preferred a change to the law represented the interests of shareholders.
- 7 Following the review, the Panel recommended better aligning the reconstruction provisions of the Companies Act with the approach in the Code by:
- a specifying that the Court can only approve schemes of arrangement that affect the voting rights of shareholders in Code companies if:
 - i it is satisfied that the shareholders of the Code company will not be adversely affected by the transaction not being undertaken under the Takeovers Code; or
 - ii the promoters of the scheme produce to the Court a 'no-objection'² statement from the Panel;
 - b providing legislative guidance to the Court (by codifying current common law principles) for determining an interest class for the purposes of voting on the resolution;
 - c specifying the two-fold voting threshold³ for shareholder approval of a scheme affecting the voting rights of a Code company, so that those shareholders voting in favour of the scheme represent:
 - i 75% of the votes cast on the resolution, at each meeting of each interest class of shareholders; and
 - ii more than 50% of the total eligible voting rights of the company;
 - d prohibiting the use of long-form amalgamation⁴ provisions in the Companies Act by Code companies; and
 - e exempting the Code company from the application of the Code if the Court approves the scheme.

¹ In this paper "promoter" has a broader meaning than that set-out in the Securities Act 1978 s2 and is used to refer to the party promoting or pursuing the transaction and may include the offeror to the shareholders of the target company or acquiror of the target company.

² Grounds for giving a "no objection" statement are likely to include that the Panel is satisfied with the quality of information to be provided to shareholders (the panel has indicated that it will require an independent adviser's report to be provided), and that adequate measures to protect shareholders' rights are implemented.

³ The voting threshold is twofold: Not only must the resolution be supported by 75% of the votes cast at a meeting of each group of shareholders that constitutes an interest class, but also the votes so cast must, in total, represent more than 50% of the total voting rights of the company.

⁴ Long form amalgamations are between two or more unrelated companies. Short form amalgamations are between two or more related companies e.g. a parent company and its subsidiary company.

- 8 I support the Panel's proposals and recommend that Cabinet agree to them. The proposals will ensure there is consistency between Companies Act and Takeovers Code provisions. The proposed changes will promote investor confidence by ensuring fair treatment of local and foreign investors. The proposals complement the government's overall aim of increasing investor confidence and participation in New Zealand's capital markets.

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Withheld under s9(2)(g(i) of the Official Information Act 1982

BACKGROUND

Schemes, Amalgamations, and Takeovers

- 10 Both the Code and the reconstruction provisions of the Companies Act regulate changes of control of New Zealand's companies. The Code is designed specifically for control-change transactions whereas the reconstruction provisions of the Companies Act are designed for more general company reorganisations (e.g. debt restructuring). This more general application contemplates a company's relationship with its creditors (e.g. lenders or debenture holders) to reorganise the company's debt and returns of capital.
- 11 The Companies Act is universal in its scope. It applies to all companies regardless of size and ownership structure. The Code applies only to companies listed on a registered exchange or those with 50 or more shareholders ("Code companies").

Takeovers under the Takeovers Code

- 12 The Code was developed by the Takeovers Panel under the Takeovers Act and came into effect in 2000. Its two main objectives were to align New Zealand's takeovers regime with international best practice - giving international and domestic investors greater confidence in our market; and to give greater confidence to small and minority shareholders by providing them with fair and equal treatment and participation in takeover situations.
- 13 The Code provides a process for acquiring a stake of more than 20% in a Code company. Takeover offers do not require the support of the board of the target company. However, full takeovers require acceptance by shareholders holding more than 50% of all of the voting rights in the target company before the bidder can take up any shares under the offer. If shareholders holding 90% of all of the target company voting rights accept a takeover offer, then the remaining 10% of shares can be compulsorily acquired by the bidder.

- 14 The Code also requires certain information to be provided to the shareholders of the target company. Details of this information are prescribed in the Code and include a report prepared by an independent adviser on the merits of the proposed transaction. The Takeovers Panel has responsibility for overseeing takeovers that take place under the Code.

Schemes of Arrangement

- 15 Companies Act Part 15 schemes of arrangement (“schemes”) are a Court supervised mechanism for effecting company reconstructions (which can include amalgamations). Schemes require the consent of the boards of the companies involved and must also be approved by the shareholders and the Court. The common law has consistently required that schemes be approved by shareholders representing at least 75% of the votes cast by those who vote on the proposal. There are also common law rules on the information that must be provided to shareholders, and the Court is able to review the scheme documentation before it is put to shareholders. These rules essentially require the promoter⁵ of the scheme to give all information reasonably necessary to enable the shareholders to judge and vote upon the proposal. No independent adviser’s report is required. Only the promoters of the scheme usually appear at the initial hearing where the documentation is put to the Court for approval.

Amalgamations

- 16 Companies Act Part 13 amalgamations are a mechanism to enable the merger of two or more companies into a single company. They require the consent of the boards of the amalgamating companies and the approval of shareholders representing at least 75% of the votes cast by those who vote on the proposal. Amalgamations are not supervised by the Court (although a person who would be “unfairly prejudiced” by the amalgamation may apply to the Court to amend or cancel the amalgamation proposal). There is certain information that shareholders must be provided with before voting on the amalgamation. This includes a copy of the amalgamation proposal, and all the information and explanation necessary to enable a reasonable shareholder to understand the nature and implications of the proposed amalgamation on the company and its shareholders, of the proposed amalgamation. There is no third-party review of the standard of information provided to shareholders.
- 17 Part 13 of the Companies Act also provides a simple process for the amalgamation of a parent company with its wholly owned subsidiaries. This process is referred to as a ‘short-form’ amalgamation (other amalgamations are referred to as ‘long-form’ amalgamations).

⁵ See above footnote 1

ISSUES RESULTING FROM USE OF COMPANIES ACT RECONSTRUCTION PROVISIONS

- 18 In a change of control involving a Code company, the transaction can be structured so that the reconstruction provisions of the Companies Act are used to avoid the application of the Code.⁶ This option can be attractive to company acquirers, as the shareholder voting thresholds under the reconstruction provisions are lower than those that apply under the Code. There is also less independent information required to be given to shareholders of a target company.
- 19 Since 2006 (when the reconstruction provisions were first used to effect a takeover) there have been a number of cases where the Companies Act provisions have been used instead of the Code. The ability to avoid the Code in this way was not anticipated when the takeovers regime was designed and it raises concerns about the integrity of the New Zealand market.

Takeovers Panel Review

- 20 In response to these concerns, the Panel initiated a review of the issue. It identified that since 2005, around 14% of change of ownership transactions involving Code companies were effected by the reconstruction provisions of the Companies Act rather than the Takeovers Code. Although there is little quantifiable economic evidence to suggest that any shareholders have been adversely affected by the transactions being structured in this way, the Panel concluded that action was warranted on the basis that avoidance of the Code may damage the integrity of the takeovers market in New Zealand.
- 21 The Panel released a discussion document with proposals to address the issue and received sixteen submissions from representatives of interest groups involved in takeovers matters, including the New Zealand Shareholders Association, the New Zealand Law Society and seven major law firms. Submissions were divided over the need for change, and about half of the submitters preferred that the status quo be maintained because of the flexibility for promoters of takeover transactions under the current arrangements. Those who preferred the status quo all represented potential scheme promoters' interests, while those who preferred a change to the law represented the interests of shareholders.
- 22 Following the review, the Panel considered that action was justified on the grounds that:
- perceptions about market integrity and procedural fairness are an important influence on the market;

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 the Code company is not the surviving company under the amalgamation. Examples of such transactions are: amalgamations of Waste Management New Zealand Limited and Transpacific Industries Group, Humanware Limited and Jolimont Capital, Dubai Aerospace Enterprise's proposed amalgamation with Auckland International Airport Limited (AIAL) and the Canada Pension Plan also proposed an amalgamation with AIAL if its partial takeover offer for AIAL was successful. A scheme under Part 15 of the Companies Act can also avoid the Code if it is structured so that no person becomes the holder or controller of voting rights in a code company. Examples of this were the merger in 2005 of Independent Newspapers Limited and Sky Network Television Limited and DNZ Foundation Property Fund Limited's amalgamation by way of scheme of arrangement of several companies in the group.

- there is no disagreement that there is an overlap between the reconstruction provisions of the Companies Act and the Code, and that this creates confusion and legal uncertainty;
- there is a risk that the use of the reconstruction provisions in place of the Code will increase if this is not addressed; and
- under the law changes recommended, New Zealand takeovers legislation would be more closely aligned with the comparable legislation in Australia.

23 In considering actions to align the Code and the reconstruction provisions, the Panel weighed up the considerations of market efficiency, shareholder rights, confidence in the market and regulatory costs. The Panel considered and dismissed a number of alternative options, including preventing Code companies from using the reconstruction provisions under the Companies Act, an “anti-avoidance” provision in the Companies Act, exempting those using the reconstruction provisions from the requirements of the Code and aligning the approval and disclosure requirements that apply to the reconstruction provisions with the approval and disclosure requirements in the Code.

24 The Panel’s final recommendation was:

- a That the Court can only approve a scheme that would have any effect on the voting rights of shareholders of a Code company if:
 - i The Court is satisfied that the shareholders of the Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code; or
 - ii The promoters of the scheme produce to the Court a ‘no-objection’ statement from the Panel⁷ (however, the Court need not approve a scheme even if a ‘no-objection’ statement is produced to the Court).
- b Legislative guidance be provided to the Court (by codifying current common law principles) for determining an interest class for the purposes of voting on the resolution;
- c That the following two-fold voting threshold⁸ be stipulated for shareholder resolutions to approve a scheme:
 - i Those voting in favour represent at least 75% of the votes cast on the resolution at each meeting of each group of shareholders (the groups to be determined by the Court, with legislative guidance, as being an interest class for the purposes of voting on the resolution); and

⁷ Panel would assess quality of information for shareholders (including a requirement for a report from an adviser independent of the scheme’s promoters, approved by the Panel)

⁸ See above footnote 3.

- ii Those voting in favour represent more than 50% of total voting rights of the Code company.
 - d If the Court approves the scheme, then the Code company would be statutorily exempt from the application of the Code; and
 - e That the use of long-form amalgamations be prohibited where an amalgamating company is a Code company, but short-form amalgamations are retained for all companies.
- 25 The effect of the Panel's recommendation would be that schemes of arrangement could continue to be used for Code companies, but that the voting procedures and information provided to shareholders would be more consistent with the provisions of the Code. The Panel or the Court would also have a role in overseeing schemes. Amalgamations under Part 13 of the Companies Act would generally be prohibited for Code companies (though amalgamations can still be effected through the schemes of arrangement provisions). This distinction has been made because amalgamations are in effect just company mergers and do not affect a company's creditor, and lender arrangements as schemes can.
- 26 The Panel considered that 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. The overall effect would be to improve fairness for shareholders, legal certainty, and market integrity.

COMMENT

- 27 The option proposed by the panel has a number of benefits. It retains the ability for changes of control of Code companies to be effected through the scheme of arrangement provisions in the Companies Act, albeit with greater shareholder protections. Schemes can be an appropriate means of effecting a change in control of a Code company.
- 28 The option also ensures that changes of control of Code companies are undertaken with third-party (the Court and/or the Panel) supervision. Because it has the effect of better aligning the reconstruction provisions with the principles of the Code, there are likely to be higher levels of shareholder participation and information provided to shareholders is likely to be of better quality.
- 29 Under the proposal, the total transaction costs for companies which would otherwise seek to use the loophole may increase (costs generally vary depending on the complexity of the transaction rather than the legislative framework used). The costs of obtaining independent advisers' reports also vary according to the complexity of the transaction. Independent adviser reports under the Code have ranged in price from approximately \$15,000 to \$100,000+.

- 30 It is envisaged the Panel will charge a fee for 'no-objection' statements. This fee may be similar to the costs for processing exemption applications (which can average from around \$10,000 to \$30,000). There could also be increased compliance costs for the promoter of the deal. The promoter may need to encourage shareholders to vote, in order to meet the >50% of total voting rights threshold.
- 31 On balance, my view is that the benefits of this proposal outweigh the potential costs. I agree with the Panel's conclusion that it is appropriate to preserve the protections of the Code for all shareholders in Code companies by aligning the Companies Act reconstruction provisions with the Code. It is also important to maintain flexibility for promoters of schemes, which this proposal achieves.
- 32 The changes will help ensure the integrity of the takeovers market in New Zealand, which is consistent with the government's overall objective of increasing investor confidence and participation in New Zealand's capital markets. I also consider that further alignment with Australia's takeovers regime will support the Government's goal of a single economic market between the two countries.

CONSULTATION

- 33 In December 2007 the Takeovers Panel issued a discussion document considering the issue of changes in control of Code companies being effected via schemes and amalgamations. The discussion document was open for three months consultation. Sixteen submissions were received from representatives of the interest groups involved in takeovers matters, including from the New Zealand Shareholders Association, the New Zealand Law Society and seven major law firms. Details are provided in the attached Regulatory Impact Statement. Submissions were divided over the need for change, and about half of the submitters preferred that the status quo be maintained because of the flexibility for promoters of takeover transactions under the current arrangements. Those who preferred the status quo all represented potential scheme promoters' interests, while those who preferred a change to the law represented the interests of shareholders.
- 34 The following agencies have been consulted on the contents of this paper: the Treasury, the Ministry of Justice, and the Takeovers Panel. The Department of Prime Minister and Cabinet has been informed.

FISCAL IMPLICATIONS

- 35 It is envisaged that the Takeovers Panel will charge scheme promoters a fee, as set in the Takeovers (Fees) Regulations 2001 (to be amended to allow this), for the giving of 'no-objection' statements. An indication of the potential fees can be given, by comparing with the current costs for processing exemption applications under the Takeovers Act. On average, exemptions can cost applicants around \$10,000-\$30,000, depending on their complexity.

- 36 Under the proposals the Panel will incur some additional costs for undertaking increased functions which fall within its core business. These costs will be met from the Panel's existing operating appropriation. They are not recoverable as they do not relate to an 'application' under the Fees Regulations.
- 37 An example of these additional costs will be the Panel's liaison with the market in advance of transactions. Such liaison is encouraged (and commonly practiced in relation to Code-regulated transactions) as it improves efficiencies for the market and helps to avoid breaches of the law.

HUMAN RIGHTS

- 38 The proposals contained in this Cabinet paper appear to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.

LEGISLATIVE IMPLICATIONS

- 39 The proposals contained in this paper will require amendments to the Companies Act 1993, the Takeovers Act 1993, and the Takeovers Code.
- 40 The Takeovers (Fees) Regulations 2001 will need to be amended in order for the Panel to charge applicants for 'no-objection' statements.
- 41 These proposals do not currently have a legislative vehicle. I will investigate options for a legislative vehicle that can accommodate these proposals at the earliest possible opportunity.

REGULATORY IMPACT ANALYSIS

- 42 The Regulatory Impact Analysis Requirements apply to the proposals due to the need to amend legislation. A Regulatory Impact Statement has been prepared and is attached to the Cabinet paper.

Quality of the Impact Analysis

- 43 The Deputy Secretary, Economic Strategy Branch, Ministry of Economic Development and the Regulatory Impact Analysis Review Panel have reviewed the Regulatory Impact Statement (RIS) prepared by the Ministry of Economic Development and associated supporting material, and considers that the information and analysis summarised in the RIS is sufficiently comprehensive and robust, and effectively communicated to enable Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Consistency with Government Statement on Regulation

44 I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- Are required in the public interest;
- Will deliver the highest net benefits of the practical options available, and
- Are consistent with our commitments in the Government Statement on Regulation.

PUBLICITY

45 I will publish a press release announcing Cabinet's decisions on the proposals contained in this paper. The proposals will also be publicised in the Ministry of Economic Development's monthly 'Business Update' newsletter and on the Takeovers Panel's website and in the Panel's periodic publication *Code Word*.

RECOMMENDATIONS

46 It is recommended that the Committee:

- 1 **Note** that the Takeovers Panel has reported to the Minister of Commerce with a series of recommendations to address concerns raised around the use of amalgamations and schemes of arrangement involving Code companies under the Companies Act 1993, instead of takeovers under the Takeovers Code.
- 2 **Agree** that a scheme of arrangement under the Companies Act 1993 that affects the voting rights of a Code company may only be approved by the Court if:
 - 2.1 the Court is satisfied that the shareholders of the Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code; or
 - 2.2 the promoters of the scheme produce to the Court a 'no-objection' statement from the Panel (however, the Court need not approve a scheme even if a no-objection statement is produced to the Court).
- 3 **Agree** that the following two-fold voting threshold be required for shareholder resolutions to approve a scheme of arrangement under the Companies Act 1993 that affects the voting rights of a Code company: Approval by shareholders representing –
 - 3.1 At least 75% of the votes cast on the resolution by those who vote, in each interest class; and
 - 3.2 More than 50% of the total eligible voting rights of the company.
- 4 **Agree** that guidelines for the Court on how to determine interest classes for the purpose of recommendation 3.1 be included in legislation and be guided by common law principles.
- 5 **Agree** that the use of long-form amalgamations under section 221 of the Companies Act 1993 be prohibited where an amalgamating company is a Code company, but that short-form amalgamations under section 222 be preserved for all companies.
- 6 **Agree** that there should be a statutory exemption from the application of the Takeovers Code where Code companies are involved in a scheme of arrangement, if the Court approves the scheme of arrangement.

Takeovers fees Regulations

- 7 **Agree** that the Takeovers (Fees) Regulations 2001 be amended to allow the Takeovers Panel to charge applicants for 'no-objection' statements.

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Withheld under s9(2)(g(i) of the Official Information Act 1982

Fiscal implications

9 **Note** that the Takeovers Panel will meet the cost of carrying out 'schemes' related functions from its existing appropriation.

Drafting instructions

10 **Invite** the Minister of Commerce to direct officials to issue drafting instruction to the Parliamentary Counsel Office to give effect to the above recommendations.

11 **Delegate** to the Minister of Commerce the power to agree to any minor policy amendments if required to give effect to these recommendations.

12 **Agree** to this Cabinet paper being published on the MED website subject to relevant deletions in accordance with the Official Information Act 1982.

Hon Simon Power
Minister of Commerce

Date signed: _____

Regulatory Impact Statement

TAKEOVERS - SCHEMES OF ARRANGEMENT, AMALGAMATIONS, AND CODE COMPANIES

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

The problem occurs on a transaction by transaction basis and does not occur frequently. While the quantifiable costs⁹ may not be significant to the economy as a whole they are to the parties involved.

Also, while there is not a lot of economic evidence to suggest that any shareholders have been adversely affected by these transactions and little consensus amongst stakeholders whether the reconstruction provisions might be used more often in future, any perceived avoidance of the Code may damage the takeovers market in New Zealand.

Additional fiscal costs noted will be met from the Takeovers Panel's existing appropriation. The proposals do not impair or override property rights and common law principles. The proposals may increase costs to business which would have carried out transactions using the loophole. However, this transactional cost is outweighed by greater shareholder protection and market confidence.

Bronwyn Turley, Manager, Corporate Law and Governance Team, CTI, MED

Bronwyn Turley, 27 July 2010

⁹ These include costs incurred by the acquirer and target company for legal and financial services.

STATUS QUO AND PROBLEM DEFINITION

Both the Takeovers Code¹⁰ and the reconstruction provisions ('schemes of arrangement', and 'amalgamations') of the Companies Act 1993 regulate changes of control of New Zealand's companies. The Companies Act is universal in its scope, applies to all companies regardless of size or ownership structure, and allows for complex major transactions to take place.

The Takeovers Code applies only to companies listed on a registered exchange or those with 50 or more shareholders (Code companies), and is primarily concerned with fair procedures that protect the rights of the shareholders of the target company and allows them to judge for themselves the merits of a change of control.

Furthermore, the Code is designed specifically for control-change transactions whereas the reconstruction provisions of the Companies Act are designed for more general company reorganisations (e.g. debt restructuring).

Takeover under the Takeovers Code

- The Takeovers Code provides regulated processes for acquiring a stake of more than 20% in a Code company. Takeover offers do not require the support of the board of the target company. However, full takeovers require acceptance by shareholders holding more than 50% of all of the voting rights in the target company before the bidder can take up any shares under the offer. If shareholders holding 90% of all of the target company voting rights accept a takeover offer, then the remaining 10% of shares can be compulsorily acquired by the bidder.
- Takeover offers also require certain information to be provided to the shareholders of the target company. Details of this information are prescribed in the Code and include a report prepared by an independent adviser, on the merits of the proposed transaction.

The Companies Act loophole

A transaction to change control of a Code company can be structured to avoid the Takeovers Code and instead be undertaken solely under the reconstruction provisions of the Companies Act. This can be an attractive option to acquirers, as the thresholds for success under the reconstruction provisions are lower than those under the Code. However, the outcome of an amalgamation or scheme can be the same as a Code compliant takeover. The Takeovers Panel ("the Panel") advises that the loophole in the law was identified and has been utilised since 2005.

¹⁰ The Takeovers Code was introduced in 2000 and sits under the Takeovers Act 1993.

Amalgamation under Part 13 of the Companies Act:

Examples of structuring transactions to take advantage of the legal loophole include the 2006 amalgamations under Part 13 of the Companies Act of Waste Management New Zealand Limited and Transpacific Industries Group, and of Humanware Limited and Jolimont Capital. In 2007 Dubai Aerospace Enterprise had proposed an amalgamation with Auckland International Airport Limited (AIAL). That proposal failed. Then the Canada Pension Plan proposed an amalgamation with AIAL if its partial takeover offer under the Code for AIAL was successful (but that takeover offer failed).

- Amalgamations are a mechanism to merge two or more companies into a single company. Amalgamations require the consent of the boards of the amalgamating companies and the approval of shareholders representing at least 75% of the votes cast by those who vote on the proposal. Amalgamations are not supervised by the Court (although a person who would be “unfairly prejudiced” by the amalgamation may apply to the Court to amend or cancel the amalgamation proposal). There is certain information that shareholders must be provided with before voting on the amalgamation. This includes a copy of the amalgamation proposal, and all the information and explanation necessary to enable a reasonable shareholder to understand the nature and implications for the company and its shareholders, of the proposed amalgamation. There is no third-party review of the standard of information provided to shareholders.
- Part 13 of the Companies Act also provides a simple process for the amalgamation of a parent company with its wholly owned subsidiaries. This process is referred to as a ‘short-form’ amalgamation, and can be contrasted with other amalgamations, which are referred to as ‘long-form’ amalgamations.

Scheme of arrangement under Part 15 of the Companies Act

A scheme under Part 15 of the Companies Act can also be used to 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 merger in 2005 of Independent Newspapers Limited and Sky Network Television Limited was the first example of this occurring. Media reports in 2008 on proposed agricultural industries restructurings indicated that schemes or amalgamations were likely to be undertaken, rather than Code-regulated transactions.

- Schemes are a Court supervised mechanism for effecting company reconstructions (which can include amalgamations). Schemes require the consent of the boards of the companies involved and must also be approved by the shareholders and by the Court. The common law has consistently required that schemes be approved by shareholders representing at least 75% of the votes cast by those who vote on the proposal (see Annex 1). There are also common law rules on the information that must be provided to shareholders, and the Court is able to review the scheme documentation before it is put to shareholders. Usually, however, only the promoters of the scheme appear at the initial hearing where that documentation is put to the Court for approval.

Schemes of arrangement and amalgamations are useful vehicles for companies to reorganise. In particular companies can use the reconstructive provisions in the Companies Act to reorganise their capital structure or debts in a way which is binding on creditors and shareholders. The reconstruction provisions have lower thresholds and obligations to shareholders than the takeovers regime, which is designed to provide protection to shareholders in takeovers situations.

The table that follows on the next page sets out these transactions, and the approximate number of shareholders affected per transaction.

Approximate number of transactions and shareholders affected*:									
	Years since the Takeovers Code came into force on 1 July 2001						global financial crisis**		
	2001/02	02/03	03/04	04/05	05/06a	06/07	07/08	08/09	09/10
Total number of Code exemptions for schemes, applied for / approved by the Panel.	2/2						1/b		1/1
Total number of transactions that used the loophole					2a Sky/INL and Waste Management	2 Dominion Property Group and Cadmus	1 Humanware	1 DNZ	
Total number of attempted transactions that have proposed to use the loophole						2c			
Total (approximate) number of shareholders of the target company					33,000	57,000c	12,000	d	250
Total number of full takeovers notified under the Code (excluding partial takeover offers, and acquisitions or allotments of parcels of shares)	13	7	5	18	6	23	12	3	5

*Data is approximate and based on the best available data at the time of writing this paper.

**The global financial crisis resulted in a lower number of transactions taking place world wide compared to previous years.

Table guide

- a The year the loophole was discovered and used in the Sky & INL transaction.
- b In 2007/08 a Code company began enquiries regarding an exemption for a scheme, but the transaction fell over.
- c Attempted takeovers involved the same target company and shareholder base.
- d Because this transaction involved privately held companies the number of shareholders is unknown.

The global financial crisis that began in late 2008 suddenly and significantly reduced takeover activity. However, the Panel advises that recovery in transaction levels is now in evidence, and that media reports indicate that the loophole remains an attractive option for avoiding the Code for some mergers and takeovers that are currently in contemplation.

The evidence indicates that the number of acquirers of control of Code companies who use the loophole to avoid the Code is relatively small when compared to the number of Code compliant transactions that occur. However, due to the large size of the companies in question (Code companies) and the number of shareholders affected, the problem's potential magnitude is considerable and may impact on the integrity of the New Zealand takeovers market.

Perceptions about market integrity and procedural fairness are an important influence on the market. Therefore, although there is not a lot of economic evidence to suggest that any shareholders have been adversely affected by these transactions and little consensus amongst stakeholders whether the reconstruction provisions might be used more often in future, any perceived avoidance of the Code may damage the takeovers market in New Zealand.

The potential adverse effect on confidence in the New Zealand market may arise because shareholders do not have the same **rights and protections** under Parts 13 and 15 of the Companies Act that they have under the Code. This is considered to be a particularly important issue because shareholders' shares are effectively compulsorily acquired under a successful amalgamation or scheme of arrangement. Such compulsory acquisitions could result in investors (both domestic and international) developing negative perceptions of the New Zealand market, affecting their willingness to invest in our capital markets.

OBJECTIVES

These objectives were used to make an assessment of regulatory options:

- clarify and make more transparent the process and procedures of takeovers that Code companies must follow to effect a takeover transaction;
- ensure that shareholders property rights which are protected by the Code are effectively maintained;
- ensure that takeover transactions (involving Code companies) are monitored by the Takeovers Panel;
- ensure that New Zealand's regulatory requirements are consistent with international best practice and provide adequate protections for shareholders; and
- maintain schemes and amalgamations as useful mechanisms for companies to reorganise, restructure, or establish a joint venture.

REGULATORY IMPACT ANALYSIS

The preferred option was identified as a result of consultation on the five 'alternative' options set out below. See Annex 2 for a summary of the procedures under the relevant provisions from the takeovers regime, the Companies Act, and the preferred option.

The preferred option is:

Part 15 of the Companies Act

- (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:
 - at least 75% of the votes cast at each meeting of each group of shareholders determined as being an interest class for the purposes of voting; and
 - more than 50% of total voting rights of the company.
- (c) codify the common law principles (see Annex 1) for determining shareholder interest classes.

Part 13 of the Companies Act

- (d) ban use of the Companies Act Part 13 section 221 '**long form**' amalgamation where a **Code company** is involved, but allow section 222 '**short form**' amalgamations related to reorganisations of wholly owned subsidiaries for all companies;

Takeovers Act

- (e) 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 Court approves the scheme.

Benefits, Costs/Risks of the preferred option

The table on the next page outlines the proposed measures under Parts 13 and 15 of the Companies Act, and the Takeovers Act and their relative benefits, risks, and costs.

Proposed measures	Benefits	Risks/Costs
<p>Companies Act Part 13: A scheme involving a Code company could only be approved by the court if:</p> <ul style="list-style-type: none"> The court is satisfied that shareholders of the Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code, or If the promoters of the scheme produce to the Court a 'no-objection' statement from the Panel. Panel would assess quality of information for shareholders (including a requirement for a report from an adviser independent of the scheme's promoters, approved by the Panel) <p>Companies Act Part 13: A scheme involving a Code company could only be approved if those voting in favour represent:</p> <ul style="list-style-type: none"> 75% of the votes cast on the resolution at each meeting of each interest class of shareholders; and More than 50% of total voting rights of the Code company. 	<p>Shareholder's interests will be further protected.</p> <p>The Court will be provided with more balanced information and be in a better position to judge whether a scheme should be approved.</p> <p>Shareholders would receive full, clear and unbiased information.</p> <p>Aligns closely with the Australian provisions.</p> <p>Higher levels of shareholder participation and protection contributing to the objectives of market integrity and confidence.</p>	<p>Total transaction costs may marginally increase (costs vary depending on the complexity of the transaction rather than the choice of legislative vehicle). The costs of independent advisers' reports also vary according to the complexity of the transaction. Independent adviser reports under the Code have ranged in price from approximately \$15,000 to \$100,000+.</p> <p>Promoters must already provide shareholders with sufficient information to meet the current statutory and common law requirements, so information requirements should impose only marginally increased costs.</p> <p>It is envisaged the Panel will charge a fee for 'no-objection' statements, this fee maybe similar to the costs for processing exemption applications (which can average from around \$10,000 to \$30,000).</p> <p>Increased compliance costs for the promoter of the deal. The promoter may need to encourage shareholders to vote, in order to meet the >50% of total voting rights threshold.</p>
<p>Companies Act Part 13: Legislative guidance is provided to the Court on how to determine an interest class for the purposes of the shareholder vote on the resolution.</p>	<p>Increases legal certainty, thereby reducing compliance costs.</p>	<p>Reduced flexibility due to higher levels of legal prescription.</p>
<p>Companies Act Part 15: The use of long-form amalgamation be prohibited where an amalgamating company is a Code company, but short-form amalgamations are retained for all companies.</p>	<p>Ensures that changes of control of Code companies are undertaken with third-party (the Court and/or the Panel) supervision.</p> <p>Information provided to shareholders is likely to be of better quality.</p> <p>Provides a workable and certain solution, thereby reducing compliance costs.</p>	<p>Some Part 13 amalgamations involving Code companies, which could have been achieved under the status quo, would not be feasible if the Court would not approve them.</p>
<p>Takeovers Act, and Code: 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 Court approves the scheme.</p>		<p>Increased involvement of the Court and the operational and legal costs associated with seeking Court approval.</p>

Alternative options

Five other options were canvassed in the Takeovers Panel's 2007 discussion paper. The key features of these options are briefly described below.

Option 1: Anti-avoidance provisions inserted into reconstruction provisions

This option would involve inserting an anti-avoidance provision (as is used in Australia) into Parts 13 and 15 of the Companies Act, so that these provisions could not be used if a Code company was involved in a transaction that was structured to avoid the Code.

The Court would continue to be involved in Part 15 schemes, and Part 13 would continue to be unsupervised. The Panel however would have an opportunity to provide some input, via a 'no-objection' statement (either to the Court or as part of a Part 13 amalgamation). As a pre-requisite for 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.

This option also included stipulating the shareholder voting thresholds as 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.

The responsibilities of the MED and the Panel would also be expanded so that these agencies could investigate complaints made by the affected parties about reconstructions, particularly where Code companies are involved.

Overall, this option would be likely to bring about important benefits, e.g. reduce promoters' ability to make a deal which impacts on voting rights without having to comply with the relatively stringent requirements of the Code, and it would align NZ law more closely with that in Australia than is currently the case.

This option, however, a) leaves an ability for promoters to undertake an amalgamation under Part 13, without third party supervision, b) applies a relatively difficult statutory test of 'avoidance of the Code' (in practice, the Australian regime has found that it is more relevant to weigh up the *outcomes* of a proposed scheme rather than the *purpose* of using the scheme mechanism), and c) technically may still leave the Code applying to a transaction that the Panel gave a 'no-objection' statement to. For these reasons, this option is not preferred.

Option 2: Statutory exemption from Code

This option includes all the key features of Option 1 but adds an extra provision which would specifically exempt schemes and amalgamations involving a Code company from the Code in situations where a 'no-objection' statement is given by the Panel.

Although this option addresses one of the difficulties with Option 1 (as stated in c) above), it is not preferred because it leaves the other difficulties (e.g. ability to undertake Part 13 amalgamation and a relatively difficult 'anti-avoidance' test) outstanding.

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

This option proposes that the shareholder approval thresholds and information requirements in respect of schemes and amalgamations involving Code companies are specified in the Companies Act and aligned with those specified in the Code for similar changes of control.

The high level of prescription would ensure that shareholders are provided with adequate information to decide for themselves the merits of the transaction. However, in situations where complex transactions are involved, significant value judgements would be needed to be made. A mechanism (such as the Court's discretion, the Panel's discretion, or some other body's discretion) would be required to determine the potential outcome of the scheme or amalgamation as compared to a Code-regulated transaction. For example, a cash scheme or amalgamation equates to a Code-regulated cash compulsory acquisition, so a 90% vote of approval could be required. However, a scrip scheme or amalgamation could result in shareholders owning a proportion of the shares in the new company.¹¹ Depending on what that level of ownership would be, it may be appropriate to stipulate a shareholder approval threshold of, say, >50%, 75%, 80%, etc. This would in turn introduce a high level of uncertainty. This option was similar to the Panel's 2006 proposals which were criticised for their uncertainty.

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

This option would mean that, to achieve a change of control of a Code company, the mechanisms under the Code or the scheme mechanism under Part 15 of the Companies Act would have to be used.

As a stand alone option, this option is not preferred because removal of Part 13 without further amendments to Part 15 may potentially disadvantage shareholders. Part 15, in its current form, does not contain the same protections as Part 13 in the way of minority buy-out rights. The Court (under Part 15) is not required to give dissentient shareholders a buy-out right. Although the Panel can appear, the Court cannot take the Code's shareholder protection procedures into account when considering whether to approve a scheme.

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

This option envisaged banning Code companies from using the reconstruction provisions of the Companies Act unless the Panel permits their use.

¹¹ 'Scrip' is a term used to describe securities such as shares, debentures, etc. If shares in the new company were provided to the shareholders under the scheme or amalgamation, they would effectively be swapping their shares in their current company with a proportion of the shares in the new company resulting from the scheme or amalgamation.

The underlying premise of this option is that schemes and amalgamations are used for no other reason but to avoid the Code. This will not always be the case, as it can be commercially sensible to undertake a transaction as a scheme or an amalgamation. Moreover, this option leaves a high level of discretion to the Panel, which may lead to increased uncertainty, whereas under the preferred option the Court is the final decision maker.

CONSULTATION

Discussion papers were published by the Panel in June 2006, and December 2007. 16 submissions on the latest paper were received from a cross sector of the legal and financial sectors as well as the NZ Shareholders Association and the NZ law Society.

Submitters generally agreed with the policy objectives, though they were divided over the need for change. Around half the submitters (depending on their likely role in transactions as promoters or not) preferring that the status quo be maintained for its greater flexibility.

Only one submitter gave costs estimates on compliance costs under different options; this indicated, and other submitters (including those who preferred the status quo) 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.

The NZ Shareholders' Association preferred Option 5, but modified by also a) defining in the Takeovers Act the term "takeover" and including schemes and amalgamations in that definition, b) amending the Code so that the same information as that required under the Code is given to shareholders under a scheme or amalgamation, and c) amending the Code to set out the requirements for the Panel's approval and to include the process for obtaining that approval.

The preferred option leaves it to market participants to determine the most appropriate structure for the transaction rather than the regulator and aims to be structure-neutral. The result should be that transactions are structured for efficiency.

IMPLEMENTATION

The preferred option will be given effect via amendments to the Companies Act 1993, the Takeovers Act 1993, and the Takeovers Code. The Takeovers (Fees) Regulations 2001 will also need to be amended in order for the Panel to charge applicants for 'no-objection' statements. The Panel will undertake its role within present funding. The proposals do not currently have a legislative vehicle. Options for a legislative vehicle that can accommodate the proposals at the earliest possible opportunity are being investigated.

The Panel will publish guidance for the market on how to obtain a 'no-objection' statement and the criteria that the Panel would apply for the giving of such a statement. Promoters of a scheme would be encouraged to liaise closely with the Panel over these issues before applying to the Court for approval of the scheme. These published policies will mitigate concerns about uncertainty regarding the 'no-objection' statement process, expressed by submitters on the Panel's discussion document.

MONITORING, EVALUATION AND REVIEW

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 also has a statutory function to keep under review the law relating to takeovers of Code companies.

ANNEX 1

The Relevant Common law principles for determining shareholder interest classes proposed to be codified under the proposals:

A class will be determined by finding a different state of facts existing among different shareholders which may differently affect their minds and their judgment;

The Court must address whether the rights and entitlements of the different groups, viewed in the totality of the scheme's context, are so dissimilar as to make it impossible for them to consult together with a view to their common interest;

The classes are to be constituted depending upon the similarity or dissimilarity of the shareholders' rights against the company and the way in which those rights are affected by the scheme, and not upon the similarity or dissimilarity of their private interests arising from matters extraneous to such rights;

Where the scheme produces a takeover, clearly the offeror and its associates have different interests from the other target company shareholders and must vote at a separate meeting;

The question of whether separate class meetings are required depends not only upon the distinct features of one group of members as against another, but upon an analysis of the effect of those differences upon both the rights to be varied under the scheme, and the new rights given by the scheme to those whose rights were to be varied.

These principles can found in the following cases:

- *Sovereign Life Assurance Company Dodd* [1892] 2 QB 573, at 580;
- *Re HIH Casualty and General Insurance Limited Ors* (2006) 57 ACSR 791, at 808, quoting *Re Hills Motorway Limited* (2002) 43 ACSR 101, at 104;
- *UDL Argos Engineering & Heavy Industries Co Limited v Li Oi Lin* [2001] 3 HKLRD 634, as referred to in *HIH Casualty and General Insurance Limited*, at 809; and
- *Re Archaean Gold NL* (1997) 23 ACSR 143, at 148; *Re Australian Co-operative Foods Limited* (2001) 38 ACSR 71 at 88.

ANNEX 2

Current procedures regulating takeovers and reconstructions, and the preferred option			
Shareholder support	Takeovers Code	Amalgamations - Part 13 of the Companies Act	Schemes – Part 15 of the Companies Act
<p>Full takeover offer needs acceptance by over 50% of total voting rights in target company, otherwise the takeover fails. A shareholder vote to approve a sale of a parcel of shares excludes the buyers/sellers and their associates. Therefore, the higher the level of control sought, the higher the effective voting threshold (e.g., if parcel to be acquired + buyer's current holding represents 30% of voting rights, >50% of the remaining 70% must approve. If parcel to be acquired + buyer's current holding represents 60% of voting rights, >50% of the remaining 40% must approve. The effective voting threshold needed to approve a transaction becomes higher because the buyer/seller & their associates can't vote. If they <i>could</i> vote, they would vote to approve of the sale. So, in the first example, effectively 66% of the shares must be voted in approval of</p>	<p>To succeed, an amalgamation needs 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.</p>	<p>To succeed, a scheme needs 75% approval by those present (or by proxy) at a shareholders' meeting and entitled to vote. No minimum % of total voting rights required.</p> <p>Court must be satisfied of compliance with statute & common law. The Panel seeks to be heard by Court (when Code companies involved) and can make submissions (but on the Companies Act, not on the Code).</p>	<p>Those voting in favour represent at least 75% of the votes cast on the resolution at each meeting of each group of shareholders (the groups to be determined by the Court, with legislative guidance, as being an interest class for the purposes of voting on the resolution); and</p> <p>Those voting in favour represent more than 50% of total voting rights of the Code company.</p> <p>Promoters of a scheme (or their associates) who are shareholders in the company would be a separate interest class for voting on the scheme</p>

	the sale (i.e., 30% (the buyer's and seller's votes) + 36% (being just over half of the remaining 70%)). In the second example, effectively 81% of the shares must be voted in approval of the sale (i.e., 60% (the buyer's and seller's votes) + 21% being just over half of the remaining 40%)			
Compulsory acquisition	Compulsory acquisition can be achieved if 90% or more of voting rights is reached. The Code sets out how the compulsory sale price will be determined.	Compulsory acquisition can be achieved if the amalgamation is approved by 75% of those present (or by proxy) and entitled to vote. No minimum % of voting rights required. No rules on sale price.	Compulsory acquisition can be achieved if the scheme is approved by 75% of those present (or by proxy) and entitled to vote. No minimum % of voting rights required. No rules on sale price.	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. Compulsory acquisition can be achieved, if scheme yes, if approved by shareholders (voting as set out above). No rules about sale price. (Note that Code companies will not be allowed to use Part 13 long form amalgamations, but non-Code companies can, and amalgamations with Code companies can still be done under Part 15 as a scheme. All companies will still be able to use short form amalgamations (between two or more related companies e.g. a parent company and its subsidiary company). Information not prescribed, but must include an independent adviser's report by an adviser who is independent of the scheme's promoters, approved by the Panel.
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	Information not prescribed but must give all information reasonably necessary to enable the recipients to judge and vote upon the proposal. No	

	required (except under Listing Rules for listed companies).	independent adviser's report required.	
Enforcement	<p>The Panel actively monitors takeover activity. The Panel makes temporary restraining orders and permanent compliance orders on its own initiative or following complaints.</p> <p>Low cost and easy access for complainants. The Panel may recover costs from a complainant if no breach is found. If persons found in breach, they pay the Panel's costs.</p>	<p>Shareholders can apply to the High Court to prevent an amalgamation.</p> <p>Companies Office reviews compliance with Part 13 requirements on filing of approved amalgamation documents.</p> <p>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.</p>	<p>The Panel actively involved in and or monitors information for shareholders (this is part of the 'no-objection' process). The Panel would appear and assist Court if requested by Court or shareholders. Shareholders could still take Court action or complain to MED.</p>
Process costs and timeliness	<p>Bidder gives takeover notice to target 2-4 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.</p>	<p>As proposals must be approved by boards of the applicant companies, negotiations precede any application to the Court.</p> <p>Interaction with the Panel during this time, re quality of information for shareholders & identification of interest classes of shareholders. Hearings for initial orders and for final orders, provide scheme proposal to Court, hold a shareholders' meeting, provide no-objection statement to Court (if sought by scheme promoters/given by the Panel) deliver Court order to the Registrar within 10 working days.</p>	<p>As proposals must be approved by boards of the applicant companies, negotiations precede any application to the Court.</p> <p>Interaction with the Panel during this time, re quality of information for shareholders & identification of interest classes of shareholders. Hearings for initial orders and for final orders, provide scheme proposal to Court, hold a shareholders' meeting, provide no-objection statement to Court (if sought by scheme promoters/given by the Panel) deliver Court order to the Registrar within 10 working days.</p>