SCHEMES OF ARRANGEMENT
AND
AMALGAMATIONS INVOLVING CODE COMPANIES

A CONSULTATION PAPER ISSUED BY THE TAKEOVERS PANEL

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1. INTRODUCTION

1. The Takeovers Panel has been asked by the Minister of Commerce to advise on the issue of amalgamations and schemes of arrangement under the Companies Act 1993 ("the reconstruction provisions") involving companies that fall under the Takeovers Code. This follows the Panel's June 2006 discussion paper on the matter, and the Panel's subsequent recommendations to the Minister of Commerce, and to the Select Committee of Parliament considering the 2006 Business Law Reform Bill.

2. Both the Code and the reconstruction provisions regulate changes of control of New Zealand incorporated companies. The Companies Act is universal in its scope. It applies to all companies regardless of size or ownership structure. The reconstruction provisions have widespread application and purpose. The Code applies to companies listed on a registered exchange and companies with 50 or more shareholders.

3. The Code and the reconstruction provisions place different rights and obligations on the parties involved in takeovers. There have been instances where takeover bids have been structured to circumvent the requirements of the Takeovers Code. The question is whether having the ability to do so is desirable.

4. The purpose of this consultation document is to seek your views on the Panel's assessment of the issue and the merits of the proposals outlined in this paper, and any other comments you wish to make. Your feedback will be used to assist the Panel to advise the Minister of Commerce on options to deal with the cross-over between the reconstruction provisions and the provisions of the Code.

5. This paper has been prepared to provide the basis for a Regulatory Impact Statement (RIS) should the Panel conclude this process by recommending that changes be made to existing laws. However, the Panel is coming to this issue with an open mind.

6. In preparing this discussion paper the Panel has been assisted by NZIER which has provided comment on a draft. NZIER will also assist the Panel with the analysis of submissions and the preparation of a RIS, should one be needed.

7. **The Panel would like to receive all submissions by 15 February 2008**.

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

2. STATUS QUO AND THE NATURE OF THE PROBLEM

Takeovers: the market for corporate control

9. The market for company shares can be thought of as containing two segments: a market for corporate control and a market for risk-return spread.

10. The threat of attempts to purchase assets that bidders judge to be underperforming is a critical factor in overcoming the agency problems that stem from the separation of ownership (i.e., by the shareholders) and management (i.e., by the company's executive and Board) in companies. The activity of assessing the value of companies and buying and selling controlling stakes contributes to efficiency.

11. Those selling and buying controlling stakes (or shares more generally) are assumed to want to maximise their own welfare. On the basis of the available information, bidders have convinced themselves (and often their financers and other backers) that by taking a risk they can improve the earnings of the assets. If they are right the improved performance would benefit them and any other shareholders. Current shareholders can go along for the ride (if the bid is for partial control). Or they can sell their shares if they are happy to accept the offer, for example if they want to realise their investment at the offer price, or if they believe the successful bidder would do worse than the incumbents. The ability to freely buy and sell shares and the availability of good information (a competitive market) are thus important safeguards to efficiency.

12. It is important to understand the significance of the issues canvassed in this paper and the context in which they are made. Cameron Partners, in a submission dated 31 July 2006 in response to the Panel's June 2006 discussion paper, said:

> *The market for corporate control is a vital element in ensuring the resources of the economy are maximised for the benefit of all New Zealanders. Harvard economist Michael C Jensen put it this way:*
>
> > *"The market for corporate control that has arisen in the last two decades is generating large benefits for shareholders and for the economy as a whole. The corporate control market generates these gains by loosening the control over vast amounts of resources and making it possible for those resources to move more quickly to their highest value use...The market for corporate control is best viewed as a major component of the managerial labour market. It is an arena in which alternative management competes for the rights to manage corporate resources." Jensen,* The Efficiency of Takeovers, *The Corporate Board, September/October 1985, pp 16-22.*
>
> *In the absence of a strong market for corporate control, sub-performing management teams become entrenched, key assets of the economy are poorly managed and all New Zealanders as well as shareholders suffer.*

13. The market for shares includes the participation of those who are primarily interested in maximising investment returns and achieving the best risk-earnings portfolio. These participants tend to rely on remote strategies, such as tracking market

announcements and the ability to buy and sell freely to manage their returns. The Panel, guided by the statutory objectives underlying the formulation of the Code, sees a change of corporate control as a significant event in which all shareholders should have the opportunity to participate.

14. Bids can proceed using various strategies. The bidders seeking control can offer an appropriate price to all, or can seek out those with a controlling holding and negotiate a price with them. In either case the share price offered may be different from that previously prevailing. Other strategies are possible.

15. The shareholders of a target company may include many small investors. Acquiring the shares of this group may prove to be an expensive exercise as it can be difficult to locate and negotiate with them individually. A takeover bidder may economise by confining the offer to those holding a controlling stake. That offer may be significantly above the prevailing price, as it is motivated by a belief that the bidder can make better returns than the current management team or direction.

16. As this document sets out, problems can arise when, during or following a change in corporate control, shareholders have no opportunity for an alternative exit when their shares are compulsorily acquired, or when they are not given the opportunity to participate in decisions about a change in control.

Background to the Takeovers Panel and Takeovers Code

17. At various times concerns have been raised about the use of different procedures that regulate the change in control of companies. Before the Takeovers Code was introduced, there was considerable concern about how this impacted on shareholders' and local and international investors' confidence in the integrity of the New Zealand market.

18. Prior to the introduction of the Code, with some exceptions for listed companies, control of companies could pass, through the sale of the shares of one controlling shareholder to another. This could occur without the knowledge or participation of the minority shareholders.

19. The Takeovers Act was passed in 1993. The provisions of the Code were introduced in 2000 and came into force in July 2001.

20. The functions of the Takeovers Panel, established under the Takeovers Act, are:

    (a) to keep under review the law relating to takeovers of specified companies and to recommend to the Minister any changes to that law it considers necessary

    (b) to keep under review practices relating to takeovers of specified companies

    (c) to investigate any act or omission or practice for the purpose of exercising its powers under the enforcement provisions of the Act

(d) to make determinations and orders and make applications to the Court under the enforcement provisions of the Act

(e) to co-operate with any overseas regulator

(f) to promote public understanding of the law and practice relating to takeovers.

21. The Panel routinely monitors the takeovers market, in the performance of the Panel's statutory functions, in order to determine whether to exercise its powers. The powers of the Panel, set out in Part 3 of the Takeovers Act 1993 are:

(a) to issue summonses and to take evidence on oath

(b) to carry out inspections and obtain evidence at the request of overseas regulators

(c) to make confidentiality orders

(d) to accept undertakings that are enforceable by the Courts

(e) to inspect documents, and to authorise the Registrar of Companies or any other person to undertake inspections

(f) to grant exemptions from the Code

(g) to enforce the Takeovers Code by making determinations, issuing restraining orders, and applying for Court orders.

22. More information about the Code and the Panel can be found at www.takeovers.govt.nz, in its Statement of Intent and in its Annual Reports.

Status quo

23. Companies that have voting securities listed with a registered exchange or have 50 or more shareholders are 'Code companies' which are subject to the specific protections, provisions and procedures of the Takeovers Code. The fundamental rule of the Code (rule 6) prohibits changes in control arising from the increase in the holding or controlling (together with associates) of more than 20% of the voting rights in a Code Company. The fundamental rule is subject to a limited number of exceptions set out in rule 7. These exceptions have the effect of permitting changes of control which may arise from the increase in the holding or control of voting rights above the 20% level. These exceptions may take the form of Code compliant offers (which may be partial or full offers), selective acquisitions or allotments.

24. The reconstruction provisions of the Companies Act also provide mechanisms which can be used to effect a change of control of a company.

25. An amalgamation under Part 13 of the Companies Act permits two or more companies to combine to form one company, following a meeting of shareholders in each amalgamating company. Combining of the companies may effect a simple

pro rata merger of all the shareholding interests. Alternatively, it may be structured to effect a change in the control of the shareholding interests, resulting in a non-pro rata outcome where one or more shareholders increase their control position in the amalgamated company, resulting in the rest having their control positions reduced or even the complete exit of the company by the other shareholders. The amalgamation may be structured so that the Code company will be removed from the Companies Office Register and the "acquiring" shareholder will continue as the holder of shares in an entity that is not a Code company. Such changes of control do not appear to have consequences under the Code.[1] Recent examples of such amalgamations include the amalgamation of Waste Management New Zealand Limited (Waste Management) and Transpacific Industries Group (Transpacific), and the amalgamation of Humanware Limited (Humanware) and Jolimont Capital (Jolimont).

26. An amalgamation, or some other restructuring of a group of companies, can also be undertaken under the "scheme" provisions of Part 15 of the Companies Act. Under a Part 15 scheme, the succeeding company effectively acquires one or more other companies. Schemes are approved by the Court. A scheme of arrangement under Part 15 of the Companies Act, as with an amalgamation under Part 13, will only have Code consequences if it results in a person becoming the holder or controller of more than 20% of the voting rights in a Code company during the reconstruction process or after the scheme has taken effect. If a scheme is structured so that no person becomes the holder or controller of voting rights in the Code company, the Code will not apply. An example of such a scheme was the merger of Independent Newspapers Limited and Sky Network Television Limited, through a new company that was formed to effect the scheme.

27. The Panel may grant an exemption from the Code's requirements in relation to the elements of a scheme which may be captured by the Code and in respect of which an exception under rule 7 is not available. A focus of concern for the Panel in granting such exemptions (which will be reflected in the conditions attached to the granting of the exemption) relates to the information to be provided to shareholders and to the shareholder voting approval thresholds. The Panel's policy on exemptions for schemes is available at www.takeovers.govt.nz .

28. An additional layer of regulation is also involved for companies listed on registered exchanges such as New Zealand Exchange Limited (NZX). Listed companies also have to comply with the Securities Markets Act's continuous disclosure requirements and the Securities Act's prospectus and investment statement disclosure requirements for offers of securities.

29. When listed companies are involved in takeovers, schemes or amalgamations, the NZX:
    (a) reviews meeting notices for schemes and amalgamations to ensure that shareholders have information in a readable and understandable form
    (b) monitors the disclosures required to be made under the Listing Rules

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[1] Such changes of control will only have Code consequences if the amalgamated company becomes a Code company (i.e., it will be listed or will have 50 or more shareholders) and the manner in which amalgamation is structured results in a person becoming the holder or controller of more than 20% of the voting rights in the amalgamated company.

(c) suspends trading in the stock 5 days after a compulsory acquisition notice has been sent to outstanding shareholders

(d) deals with applications for waivers and with complaints of breaches of the Listing Rules.

30. In addition, the Securities Commission (which is established under the Securities Act) has an oversight role in respect of offer documents and market practices that might mislead securities markets participants.

31. The following table compares the key features concerning changes in control under the Code, and Parts 13 and 15 of the Companies Act.

Table 1. Current procedures regulating takeovers and reconstructions			
	Code Takeovers	**Amalgamations - Part 13 Companies Act**	**Schemes – Part 15 Companies Act**
Shareholder support	Full takeover offer needs acceptances by more than 50% of the total voting rights in target company. A vote on an acquisition or allotment excludes the buyers/sellers and their associates. The higher the level of control sought, the higher the effective voting threshold. A takeover offer can be extended to up to 90 days (and up to 150 days in total in some circumstances). Conditions must be met no more than 30 days after offer closes.	75% approval by those present (or by proxy) at shareholders' meeting and entitled to vote. No minimum % of total voting rights required for approval. Approval is obtained at a single shareholders meeting. If either company is listed, related parties can't vote. Minorities may be able to require company to buy-out their shares, if they voted against the proposal. No apparent time limits on conditions. Courts have not been tested on tolerance to lengthy/substantial conditionality of proposals.	75% approval of a Court-approved scheme by those present (or by proxy) at a shareholders' meeting and entitled to vote. No minimum % of total voting rights required for approval Court must be satisfied of compliance with statute and that the scheme was such that an intelligent and honest person … might reasonably approve. Panel has decided it will seek to be heard by the Court and can make submissions. Courts have not been tested on tolerance to lengthy/substantial conditionality of proposals.
Compulsory acquisition	Available once a person reaches 90% or more of the 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, all shares of the amalgamating company are surrendered for shares in continuing company or other consideration. No minimum % of total voting rights required for approval.	If approved by 75% of those present (or by proxy) and entitled to vote, all shares are surrendered for shares in continuing company or other consideration. No minimum % of total voting rights required for approval.
Shareholder Information	Prescribed information, such as directors' recommendation, information about the offeror, disclosure about any agreements by other shareholders, or likely material changes to the business of the target (if offeror gains control of company), and an independent adviser's report.	Information (provided by the interested parties) must 'enable a reasonable shareholder to understand the nature and implications' of the proposal. No independent adviser's report required (except under the Listing Rules for listed companies). S220 sets out in general terms the information a proposal must contain, but it's minimal by comparison with Code requirements and has no specifically mandated information.	Information (provided by the interested parties) must give all the information reasonably necessary to enable the recipients to judge and vote upon the proposal, but tends to be minimal by comparison with Code requirements and has no specifically mandated information. No independent adviser's report required.

Table 1. (Cont)			
	Code Takeovers	**Amalgamations – Part 13 Companies Act**	**Schemes – Part 15 Companies Act**
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 has the option of recovering costs from a complainant if no breach is found. Those found in breach pay Panel's costs for enforcement action.	Companies Office reviews compliance with Part 13 procedural requirements on filing of amalgamation documents, after shareholders have approved the amalgamation. Shareholders can complain to the relevant MED unit investigating Companies Act breaches and unit may prosecute. This can result in penalties, but would not halt or amend an amalgamation. Shareholders can apply to the High Court to prevent an amalgamation under s 226 Companies Act.	No routine monitoring of compliance by any regulatory agency. The High Court approves arrangements, amalgamations and compromises under s 236. This includes approval of scheme documents, calling of meetings and meeting procedures prior to the putting of the scheme to shareholders and final approval post shareholders' meetings. 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, with draft offer doc to target. 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.

Nature of the problem

The issue

32. In a takeover involving a Code company the bidder and some shareholders in, and the Board of, the target company can, and sometimes do, structure takeover bids to circumvent the Code, using provisions in the Companies Act.

33. There is a concern about how this might affect shareholders and the integrity and competitiveness of the New Zealand capital market.

34. The Panel regards market integrity as a situation where there are clear property rights, clear, fair and consistent rules about the protection and exchange of those rights, enforcement of the rights, predictable outcomes (e.g., in the case of a dispute), and transparency. In the corporate control context integrity is about protecting the legitimate interests of all shareholders by ensuring that control of companies cannot change without the appropriate participation of all shareholders.

35. Competitiveness in this context is the ability to freely change the control of ownership, which is helped by there being potentially many buyers and sellers of shares, cost-effective mechanisms that facilitate the making and considering of offers, and good information available at reasonable cost.

36. When the Panel was formulating the Takeovers Code, it had to strike a balance between the competing objectives set out in section 20 of the Takeovers Act. The rules of the Code provide procedures that regulate for fairness and the autonomy of shareholders' decision making, while also encouraging competition for control and the efficient allocation of resources. The reconstruction provisions of the Companies Act were not drafted with the Takeovers Code's objectives in mind.

Discussion

37. The Panel's concern at the use of the reconstruction provisions to effect changes of control of Code companies has spanned several years. It was heightened by the amalgamation transaction which occurred in 2006 whereby Transpacific effectively took over Waste Management, a New Zealand listed Code company without having to comply with the Code. The reconstruction provisions of the Companies Act were used instead. Shareholders of Waste Management received cash for their shares.

38. The Panel was contacted by many market participants, including shareholders and brokers, about the amalgamation of Waste Management and Transpacific. There was a concern, widely reported in the media, that the integrity of the New Zealand market would suffer if the provisions of the Code could be avoided by adopting a mechanism to acquire a Code company outside the provisions of the Code.

39. After that transaction the Panel became aware of a scheme of arrangement involving the amalgamation of three companies of the Dominion Funds Group, and an amalgamation involving Humanware and Jolimont (an Australian equity fund). Most recently there was the (now aborted) amalgamation proposal involving Auckland

International Airport Limited and Dubai Aerospace Enterprise, and the subsequent (and also firstly aborted, but then reactivated) amalgamation proposal involving Auckland International Airport and a Canadian pension scheme.[2] Cadmus Technology Limited and Provenco Group Limited have also announced an intention to undertake an amalgamation to merge their businesses. They are both Code companies. Media speculation about the future of The Warehouse Group Limited also indicates that a bidder would likely use the Companies Act reconstruction provisions, rather than the Code, to pursue a takeover.

40. When the Code procedures are circumvented, the statutorily mandated Code protections are denied to shareholders (e.g. information, timing, independent advice and participation). In these circumstances, shareholders may see themselves as disadvantaged or may be aggrieved if they had no chance to participate effectively in the decisions about proposals. Potential consequences are that:

- their shares are being compulsorily acquired at a low level of shareholder approval, and/or at a lower price than they would have been willing to accept
- they find themselves amalgamated with a new controlling group that was not in place when they bought their shares, where they have no confidence in the new ownership *and* they cannot sell their shares (e.g., because the market also has no confidence in the new ownership and/or the stock has become illiquid)
- they find they are not treated equally with all shareholders
- they lose confidence in the capital markets.

Shareholder support

41. Under the Code a full takeover cannot succeed (that is, no shares can be taken up by the offeror) unless the offeror receives acceptances of its offer that result in the offeror holding or controlling more than 50% of the voting rights in the target company. One consequence of a takeover that achieves more than 50% but less than 90% control is that the original shareholders in the target company may retain a minority (sometimes less than 20%) shareholding.

42. Reconstructions can proceed if approved by 75% of the votes cast by those entitled to vote and who actually vote at a meeting (or by proxy). There are no restrictions on who is eligible to vote nor is there a minimum number who must vote. Accordingly, the level of shareholder support may well be less in terms of total voting rights than under a Code offer, and will almost certainly be less than the 90% required under the Code to proceed to a compulsory acquisition of the shares.[3]

[2] At the time of publication of this paper, the Canadian bidder, the Canada Pension Plan Investment Board, announced an intention to undertake a partial takeover to obtain 40% of Auckland International Airport, under the Code, which, if successful, would be closely followed by an amalgamation proposal under the Companies Act.

[3] If the target company is listed on the NZX, an amalgamation proposal is a related party transaction covered by listing rule 9.2, and must be approved by an ordinary resolution of the company, where related parties and their associates are unable to vote on such a resolution (unless it is carried out under Part 15 of the Companies Act, in which case it is exempt, or unless the requirement is waived by the NZX).

43. This was the case in respect of the amalgamation of Waste Management and Transpacific referred to above. In that case a special resolution was passed, with around 97% approval. However, the holders of only approximately 47% of the total voting rights in Waste Management exercised their voting rights. Accordingly, the amalgamation proceeded (and all the shares in Waste Management were acquired by Transpacific) with the support of the holders of less than 46% of the total voting rights in the Code company.

44. If a parcel of voting rights of more than 20% is sought under an acquisition or allotment under rule 7(c) or 7(d) of the Takeovers Code, an ordinary resolution of the Code company is required, but interested parties and their associates cannot vote on the resolution. The higher the percentage of control sought the fewer are the number of shareholders who would be eligible to vote to approve it. The effective approval threshold (in relation to a company's total voting rights) therefore can be very high under this Code process.

45. A significant difference between takeovers undertaken under the Code and schemes or amalgamations undertaken under the Companies Act is that, for the latter, approval is attained at a single meeting of shareholders of the target company. This gives a degree of certainty in outcome for the promoters of amalgamations or schemes once the company's meeting has been held.

46. But decisions being made at company meetings occur in a more restrictive time frame than Code takeovers so could be regarded as being more pressured for shareholders. In the case of a Code takeover, shareholders have a minimum of 30 days, and usually a longer period than that, in which to consider what they wish to do with their shares.

47. Under the reconstruction provisions the rights of shareholders are significantly diluted when compared to an analogous Code offer, through lower approval thresholds and a more pressured situation in which to consider proposals. This is inconsistent with the fair treatment and autonomous decision-making objectives of the Code.

<u>Compulsory acquisition</u>

48. Under the Code the compulsory acquisition provisions are triggered when a person becomes the holder or controller of 90% or more of total voting rights in the Code company. The high threshold required for compulsory acquisition reflects the conventional view that a person should not be forced to sell their property except in very limited circumstances and for very good reasons. A 90% compulsory acquisition threshold under the Code is consistent with similar requirements in many other countries.

49. Shareholders are sensitive about having their shares compulsorily acquired. The Panel has received a number of complaints over the years from shareholders whose shares are being compulsorily acquired in the course of various Code takeovers.

50. Under a reconstruction, all shares of one or all of the companies involved will, in effect, be compulsorily acquired. Once the proposal is approved shareholders cannot choose to continue to hold their shares in the amalgamating company. The threshold

is approval by a resolution of 75% of voting rights exercised at a meeting of the company. As illustrated above, such a resolution can be passed by the holders of less than half of the company's total voting rights, depending on how many shareholders choose to exercise their voting rights.

51. The Panel has received a number of comments suggesting that it would be impossible to achieve a 90% of voting rights approval at a shareholders meeting because of the combination of timing issues, shareholders who cannot be found, and passive fund investors who cannot vote. The use of the reconstruction provisions may overcome this potential barrier to efficient allocation, and may diminish the opportunities for "greenmail" by holders of parcels of 10% or more of shares, but it comes at a cost of diminished rights of Code company shareholders.

52. In brief, under the reconstruction provisions, the protection against compulsory acquisition is significantly diluted when compared to an analogous Code offer.

Shareholder information

53. The Code prescribes what information must be included in materials for shareholders:

    (a) an independent report for shareholders on the merits of the transaction, to be prepared by an independent adviser approved by the Panel

    (b) disclosure of key assumptions used in the valuation of any asset or prospective financial information about the target company, and the full valuation report must be made available upon request

    (c) disclosure of who has already agreed to accept the offer, the material terms of the agreement, and details of the ownership of equity securities in the target, including shares held or controlled by the offeror

    (d) a statement of the general nature of any material changes likely to be made by the offeror to the business activities of the target company and its subsidiaries unless its offer requires 90% acceptance (and that condition is not waiveable).

54. Under an amalgamation the Companies Act prescribes only some of the information that is to be provided, such as the terms of the amalgamation proposal, information about the constitution of the amalgamated company, a description of minority buy-out rights, and the material interests of directors in the proposal. Beyond this, Part 13 requires that shareholders be provided with "*such further information and explanation as may be necessary to enable a reasonable shareholder to understand the nature and implications for the company and its shareholders of the proposed amalgamation*". What is necessary to enable a reasonable shareholder to understand the proposal is a matter for the directors of the amalgamating companies to decide. There is no regulatory review of the information that is put to shareholders under the proposal.

55. An independent appraisal report may be required by the Listing Rules if any of the amalgamating companies is a party to a listing agreement with the NZX, because the parties are regarded as related.

56. The Companies Act does not specify information to be provided to shareholders in respect of a scheme. However, the standard applied by the Court in approving a scheme proposal is that it gives shareholders all the information reasonably necessary to enable the recipients to judge and vote upon the proposal.

57. Submitters on the Panel's earlier discussion documents relating to the use of schemes and amalgamations emphasised the robustness of the Court process and the breadth of the Court's mandate. The Court must consider the rights of all parties involved in the scheme, not just those of the shareholders. However, although third parties (such as the Panel) may be able to influence the orders made by the Court, the fact is that Court applications are generally made by the promoters of the scheme without any other input. In practice, though, there is no substitute for genuinely competitive advice from a party with a different point of view, representing different interests. That does not happen in most schemes.

58. The differences in the information that needs to be provided to shareholders when considering an offer under the Code compared with Companies Act reconstructions are significant. While some of this information (such as an appraisal report) may be provided in the case of schemes involving listed companies (because of the NZX's Listing Rules), the absence of prescribed information requirements means that some crucial but sensitive information may be omitted from a scheme proposal. There is no consistency in the scope of disclosures that are required for a scheme or amalgamation, as compared with a Code offer.

59. The inferior information may inhibit shareholders from making well-informed decisions on the merits of a proposed transaction. This conflicts with the Code's objectives that shareholders must ultimately decide the merits of a takeover offer and of encouraging the efficient allocation of resources; the better informed the participants in the market the better the decisions that they will make. The Panel considers that the lack of a requirement under the reconstruction provisions for a report prepared by an independent adviser is a particularly significant issue.

Equal consideration

60. Rule 20 of the Code requires that the consideration offered under a takeover be on the same terms and provide the same consideration to all offerees, regardless of the size of their shareholding. There are no such constraints in the case of an amalgamation or a scheme.

61. The provisions in the Companies Act are somewhat more flexible than the Code when it comes to the types of transaction that can be effected (and the payment of consideration). This was the substantive reason for the inclusion of provision for Court-approved schemes in the Companies Act. Amalgamations also provide greater flexibility when it comes to paying consideration to shareholders.

62. For example, in a transaction under the Code, the consideration must generally be paid no later than 7 days after the offer goes unconditional, or 7 days after the end of the initial offer period. Sometimes takeover transactions involve delays in the payment of consideration to shareholders in a commercial relationship with the target

to accommodate earn-out provisions or the achievement of performance targets. Sometimes these are difficult to accommodate in a Code takeover.

63. There are instances where a major shareholder also has a commercial relationship with a target company, such as under a distribution agreement. Sometimes, when a change of control is being sought through a takeover, the bidder will also wish to change these types of arrangements that the target company has in place. This may mean the payment of compensation to a contractual party for termination of existing agreements. Such arrangements will be acceptable to the Panel under a Code offer provided the payments represent fair value and are not simply a means of paying additional consideration to encourage them to sell their shares to the bidder.

64. The Panel has also seen an instance where some shareholders of an amalgamating company were given the opportunity to subscribe for shares in the continuing entity when others were not. It was not clear just how favourable the terms of those reinvestments were, however it could not have occurred under the Code without close scrutiny by the Panel.

65. In brief, while the reconstruction provisions offer more flexibility on control transactions that cannot always be accommodated by Code offers, the Panel is concerned that the use of the reconstruction provisions does not guarantee the offering of equal consideration to shareholders.

Enforcement

66. The Panel monitors all Code transactions and the market generally, and can take action against apparent breaches of the provisions of the Code. The Panel's broad enforcement powers, and willingness to act quickly on apparent breaches, have contributed to a high level of compliance with the provisions of the Code.

67. The Companies Office monitors compliance with the procedural provisions of the Companies Act in relation to amalgamations conducted under Part 13 of the Act (after the proposal has been put to and voted on by shareholders), but not Part 15 schemes. In reconstructions, there is no competitive tension that might ensure proper scrutiny of a proposal (because they always require the cooperation of the boards of the companies involved), although the need for Court approval adds an additional layer of impartial oversight to scheme proposals.

68. Under the reconstruction provisions, aggrieved shareholders can, in certain circumstances:

   (a) apply to the High Court under section 226 of the Companies Act if they consider that they would be unfairly prejudiced by an amalgamation proposal

   (b) apply to be heard by the High Court when the that Court considers the requirements for a scheme to proceed.

69. These avenues require the shareholder to be aware of the requirements and remedies available under the Companies Act, and to be proactive. Taking action through the

Court system can be costly, and will be unaffordable for most shareholders. The remedy under section 226 appears to be used rarely.

70. Relying on private enforcement rights may effectively disempower some shareholders. Recent trends in New Zealand are towards enabling regulatory agencies to act on behalf of the public generally to enforce the law. The Panel and the Securities Commission are two such agencies.

71. It is generally accepted that well-regulated markets engender the confidence of investors and encourage the participation of the widest range of players. The mechanisms currently exist to effectively regulate the takeovers market where Code transactions are used. They exist with a narrow focus in respect of changes of control being carried out as amalgamations under Part 13 of the Companies Act and exist to a lesser extent than under the Code in respect of changes of control carried out through the scheme of arrangement provisions of the Companies Act.

72. In brief, the Code provides for a complaints vehicle at relatively low cost to aggrieved parties, whereas under the Companies Act complainants may face barriers to challenge outcomes, and the light-handed monitoring and enforcement with respect to schemes and amalgamations may undermine the integrity of the market.

Process costs and timeliness

73. The final objective for the formulation of the Code relates to the maintenance of a proper relation between the costs of compliance with the Code and the benefits resulting from it. It is difficult to compare the actual costs of undertaking a Code offer, a scheme or an amalgamation.

74. The Panel would be interested to know from experienced market practitioners how the costs for the bidder and the target companies in an amalgamation or a scheme of arrangement tend to compare with the costs of achieving the same result through mounting an offer under the Takeovers Code. The Panel is interested in understanding the direct costs – the money paid to undertake the transaction, staff time diverted, and the "red-tape" costs – the indirect costs such as non-productive time.

Approaches overseas

75. Certain overseas jurisdictions allow schemes for (their equivalent of) Code companies, but the procedures are subject to additional regulatory involvement. For example:

    (a) In the United Kingdom a scheme is considered an offer for the purposes of the City Code (i.e., the UK's takeovers code) and as such must comply with many of the requirements of the City Code

    (b) Schemes of arrangement in Australia are governed by Chapter 5 of the Corporations Act. Takeovers are governed by Chapter 6 of the Corporations Act. Amalgamations as we know them in New Zealand under Part 13 of the Companies Act (i.e., that are not undertaken as a scheme of arrangement) are not permitted at all. Under Australian law:

- The Australian Securities and Investments Commission (ASIC) requires the promoters of a scheme to provide the scheme proposal and draft shareholder information to ASIC at least 14 days (as a bare minimum) in advance of the hearing for initial Court orders. ASIC reviews the proposal and documentation and often appears at both the hearing for initial orders and also for final orders.

- Section 411(17), in Chapter 5 of the Corporations Act, provides that a Court cannot approve a scheme of arrangement unless the Court is satisfied that the compromise or arrangement has not been proposed for the purpose of enabling any person to avoid the operation of any of the provisions of Chapter 6 of the Corporations Act (i.e. the takeover provisions); or unless ASIC provides a "no-objection" statement. ASIC will only provide a "no-objection" statement if it is satisfied that shareholders will receive equivalent treatment and protection under a scheme as they would receive under the takeover provisions of the Corporations Act. This impacts largely in respect of the information to be given to shareholders and ensuring fairness to all shareholders (the Eggleston principles). The basic question that ASIC considers is whether shareholders are adversely affected by a takeover being undertaken as a scheme.[4]

- A scheme must be approved by shareholders representing 75% of the shares that are voted, as well as by more than 50% in number of those eligible to vote and voting. A great deal of emphasis is given to different classes of interests of the shareholders. The approval thresholds referred to above must be given in respect of each class of voters. There is much case law in Australia on determining the different classes. "Interested shareholders", i.e., those who promote the scheme, and their associates, are expected (by both ASIC and the Court) to vote as a separate class.[5] If they do not separate their votes from those of the other shareholders, the Court would likely not approve the scheme.

Scale, scope and effects

76. There are some 474,000 registered companies subject to the New Zealand Companies Act. The Code is concerned with New Zealand registered companies that have voting securities quoted on a registered exchange's market and those companies that have 50 or more shareholders. The Code therefore covers a small subset of all registered companies:

    (a) as at November 2007, the NZSX and NZAX markets had 136 New Zealand Code companies listed [6]

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[4] See ASIC's Regulatory Guides No.s 60 *Schemes of Arrangement* and 142 *Schemes of arrangement and ASIC review*.
[5] See paragraph RG60.09 of Regulatory Guide No. 60 and paragraph RG 142.46 of Regulatory Guide No.142.
[6] Listed companies that have only debt securities quoted are not Code companies (unless they have 50 or more shareholders).

(b) according to the Companies Office database, there are currently 218 unlisted New Zealand Companies with 50 or more shareholders (and a total of 543 companies that indicate they have 'extensive' shareholders). [7]

77. The Takeovers Code only pertains to one specific event (a change in corporate control) among many events that affect the performance of a company. The focus of the Panel and this discussion paper is about the process surrounding changes in corporate control and the opportunity for all shareholders to participate in that event, particularly when it may result in a compulsory acquisition of shares.

78. Since 1 July 2001 the Takeovers Panel has:

(a) recorded a total of 97 offers, 13 for partial control and 84 for full control; that is around 14 offers for full control per year; many of these involved compulsory acquisitions

(b) granted 2 exemptions from the Code for schemes of arrangement undertaken under the Companies Act

(c) become aware of four completed amalgamations or schemes that appeared to be used deliberately to avoid the Code (as well as a number of such proposals and recent attempts).

79. In the 2006/07 year, the Panel recorded 23 takeover notices and 29 exemption applications (but these exemption applications were not related to schemes or amalgamations), and made one application to appear in the High Court regarding a scheme (Annual Report 2007).

80. While it is not known how the use of amalgamations and schemes has impacted on shareholders in monetary terms, the Panel is concerned that circumvention of the procedures provided by the Code has adversely affected the rights of shareholders in Code companies to participate in crucial decisions about changes in corporate control, regardless of the substantive outcome.

81. Considering the information in paragraph 76, above, it seems likely that the Code covers only a small minority of New Zealand companies – although the companies covered by the Code are New Zealand's most substantial companies.

[7] This number of unlisted companies with 50 or more shareholders should be treated as a potentially arguable ballpark estimate only, as the Takeovers Panel has had some involvement with a number of unlisted Code companies that are not shown in the Companies Office database list. Thus, for unknown reasons the match is clearly not perfect and there may be significantly more than 218 unlisted Code companies in New Zealand.

Summary of the problem

82. Although the outcome of an amalgamation or scheme can be the same as a successful full takeover offer that goes to compulsory acquisition, the requirements of the Code are designed to be fairer, to provide equality of treatment and to give shareholders in the target company greater protection from the potential adverse consequences of a change in control:

    (a) the shareholder approval thresholds for amalgamations and schemes are in effect lower than for Code offers

    (b) shares can be compulsorily acquired at a significantly lower approval threshold under an amalgamation or scheme than is provided in the Code

    (c) shareholders receive generally inferior information in respect of a proposed amalgamation or scheme than they would in respect of a Code offer

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

    (e) under the Code the consideration and terms of the offer must be on the same terms regardless of the size of the shareholding, but there are no such constraints in the case of an amalgamation or a scheme

    (f) the Code provides for a complaints vehicle at a nil or a relatively low cost to aggrieved parties, whereas under the Companies Act complainants may face legal and Court costs.

83. However, the Panel recognises that an important element of the reconstruction provisions is the requirement for board approval of an amalgamation or a scheme before it is put to shareholders. Sometimes this may be anti-competitive. Sometimes this may be value-enhancing. Boards have statutory duties such as the requirement to act in the best interests of the company. Yet the Panel's concerns are not so much that the *outcome* of a scheme or an amalgamation may be undesirable. Rather, the Panel's concern focuses on the process that is adopted to achieve the outcome.

84. The use of the reconstruction provisions may create benefits for the offeror and for at least some of the shareholders of the target company:

    (a) greater certainty of outcome – one shareholder meeting determines the success or failure of the proposal, unless offers are conditional

    (b) greater speed (although there have been instances of lengthy conditionality to proposed amalgamations that could see months pass before the outcome is known)

    (c) possibly lower direct cost, for example, because of different prescribed information requirements or different legal fees. (Please note however that the Panel is looking for submitters to help with this information).

85. Potential costs arising from the ability to circumvent Code requirements might be that such circumvention –

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

    (b) raises the risk premium associated with investing in New Zealand, hence discounting share values

    (c) generates waste, as companies spend resources on structuring transactions in such a way as to enable the use of legal loopholes, rather than productive activity

    (d) results in a lower share price, as reduced competition in friendly 'takeovers' essentially forecloses other offers

    (e) results in unequal consideration for some shareholders

    (f) results in a pressured decision or compulsory acquisitions at too low a threshold, so that some shareholders sell (under a compulsory process once the approval threshold is met) at a price that is lower than one at which they would have wished to sell.

86. The latter two potential effects affect the distribution of wealth (equity), but not total wealth (efficiency). In principle, transfers of wealth from one to another group cancel out in a cost benefit analysis of the impact of a policy on societal welfare. There may be policy or political reasons to weight one group's interests higher than others, in particular when this involves the protection of individual property rights and enables the participation by all shareholders in decisions on the merits of a control-change transaction.

87. When in 1999 NZIER studied the impact on the value of shares following takeovers of 40 listed companies over the period of 1995-1997 it found that:

    (a) with only one or two exceptions takeovers were beneficial for all shareholders

    (b) the positive impact of a takeover on share prices persists over time, meaning that shareholders who did not participate in the takeover decision at the time were not disadvantaged if they sold later

    (c) in the vast majority of cases the same offer was made to all shareholders, not just to those with controlling stakes

    (d) in cases where a separate offer was made, the price was usually the same (but there were instances of higher and lower prices offered to minority interest following an independent determination)

(e) shareholders in target companies enjoyed a premium where the bid was for 100% instead of bids for a controlling share of less than 100%.

88. While economic outcomes are important, the Panel puts particular emphasis on ensuring procedural fairness. The Panel regards the Code's procedures as prescribing a minimum standard. It is therefore concerned that where alternative procedures are used they can give rise to an inferior process with negative effects on shareholders' rights.

89. The Panel also regards certainty of process to be of value and is thus concerned about the effect of 'forum-shopping' on the integrity of the New Zealand market place.

90. Furthermore the Panel believes that the use of the reconstruction provisions to effect changes of control of Code companies may not be consistent with the intent of the takeovers legislation, as:

(a) the Code provides that parties cannot choose to contract out of the Code

(b) the Panel can only grant exemptions from compliance with the Code if to do so would be appropriate and consistent with the objectives of the Code.

91. As a consequence the Panel believes, on balance, that having the ability to use the reconstruction provisions of the Companies Act to bring about changes of control of Code companies is a significant problem.

92. The remainder of this paper discusses alternative ways of addressing this problem.

3. POLICY OBJECTIVES

93. As outlined in the introductory section, the objective of changing corporate control, whether through Code takeovers, schemes of arrangement or amalgamations, is to maximise the returns on available resources, which in turn maximises the welfare of society. The Code and Parts 13 and 15 of the Companies Act provide for different mechanisms to effect changes in corporate control.

94. With this broad objective in mind, to determine whether the current regime or alternatives would be of net benefit to society, options are assessed against the objectives in section 20 of the Takeovers Act. These are set out in the following table, which highlights more clearly the sometimes competing goals of efficiency, and procedural and substantive fairness.

Table 2. Policy objectives

S.20 Objective	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.

4. OPTIONS

95. There appear to be five principal alternatives to the option of maintaining the status quo, to address the problems arising from the use of the reconstruction provisions to effect changes in control of Code companies. These are discussed below.

96. These options are intended to generate discussion and to assist in reaching conclusions on the way forward. The Panel encourages readers to put forward their own variations or alternatives to the options canvassed here.

Outline of the options

Option 1 Anti-avoidance provisions inserted into reconstruction provisions

97. Under this option the Companies Act would be amended to bring the use of the reconstruction provisions, where Code companies are involved, more into alignment with the position in Australia. This could involve the following matters:

    (a) an anti-avoidance provision would be inserted into each of Parts 13 and 15 of the Companies Act, to the effect that that Part of the Companies Act could not be used if a Code company was involved in the amalgamation or scheme and the amalgamation or scheme had been proposed to avoid the Code;

    (b) Under the Part 15 provision, the Court would not be able to approve a scheme unless the Court was satisfied that the scheme had not been proposed to avoid the Code, or unless the Panel had provided a "no-objection" statement.[8] A similar "no-objection" statement could also be a prerequisite for an amalgamation under Part 13 of the Companies Act;

    (c) The Australian requirements also include that the scheme must be approved by shareholders in each class representing 75% of the shares that are voted as well as by more than 50% in number of those voting. The Panel has had strong views expressed to it, in the context of exemption applications, against a 50% by number threshold because of the disproportionate power that can give to minority shareholders. It might therefore be more appropriate in the New Zealand context for an amalgamation under Part 13 or a scheme under Part 15 to either:

        - mandate the voting requirements as being approval by 75% of the votes of those voting and by 50% of total voting rights, of each of the companies involved; or

        - leave the position as it is currently, whereby the common law is applied by the Court for the voting threshold (i.e., approval by 75% of the votes of those voting).

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[8] The Panel would develop and publish policies regarding how parties would obtain a no objection-statement from the Panel, much as ASIC has done in Australia – see footnotes 4 and 5, above.

(d) The question as to whether "interested shareholders", i.e., the promoters of the scheme and their associates, should be required to vote in a separate class from other shareholders (as occurs in Australia) could be left to the current common law position, under which shareholders with sufficiently different interests must be constituted as separate classes and vote at separate meetings (see, e.g., *Re National Dairy Association of New Zealand Limited* [1987] 2 NZLR 607; *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573, etc).[9]

98. It is also proposed that:

(a) the responsibilities of the Ministry of Economic Development could be expanded to provide for the investigation of complaints about compliance with the provisions of the Companies Act relating to amalgamations and schemes; and

(b) the Panel's statutory functions would be explicitly expanded to enable it to investigate complaints about schemes and amalgamations where Code companies are involved. The Panel would report to the Courts at the time that initial or final orders are being considered for schemes.

Option 2: Statutory exemption from Code

99. A second alternative would be to amend the Takeovers Act and the Code to exempt schemes and amalgamations involving a Code company from the Code. At the same time the Companies Act would be amended so that the Panel was involved in the processes as described under Option 1. A carve-out of this nature would provide greater legal certainty, unlike Option 1 which still leaves the Code applying to some schemes and amalgamations involving Code companies.

100. As under Option 1, the responsibilities of the Ministry of Economic Development and the Panel would be expanded to become proactive in investigating complaints about schemes and amalgamations in relation to compliance with the requirements of the Companies Act, particularly where Code companies are involved.

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

101. A third type of solution would be to amend the reconstruction provisions of the Companies Act so that:

(a) shareholder approval thresholds in respect of schemes and amalgamations are specified in the Companies Act and are consistent with the requirements of the Code, where Code companies are involved, for similar changes of control

(b) any scheme or amalgamation proposal involving the change of control of a Code company provided to shareholders must contain the same information as would be provided in respect of a Code offer with a similar outcome.

[9] However, this would not deal with the issue of classes of interests in relation to voting on Part 13 amalgamations. For that reason, and because of the difficulties of ensuring compliance with the proposed anti-avoidance provision, Option 1 would probably function optimally in conjunction with Option 4.

102. In making the alignment there are issues of interpretation to decide. These include the degree of shareholder approval necessary (appropriate approval thresholds) and coverage (which shareholders, if any, should *not* be eligible to vote on any particular resolutions.)

103. The differences between the processes being brought together means there are several practical ways of interpreting the aim of this type of solution.

Approval thresholds

104. Currently schemes and amalgamations are approved (by law, or by Court order) by 75% of voting rights of shareholders eligible to vote and voting at a meeting (or by proxy) of the company. The Code has an approval level of more than 50% of total votes for a takeover offeror to be able to take up the shares accepted into the offer, and 90% of total voting rights to have the right to compulsorily acquire all outstanding shares.

105. All schemes and amalgamations involve “compulsory acquisition” because once a scheme or amalgamation is approved all the shares of the amalgamating companies are “acquired” (in practice cancelled) and the former shareholders will receive shares in the surviving (amalgamated) company, other securities, and/or cash depending on the nature of the scheme or amalgamation. These different forms of outcome can be seen as falling differently under the Code, and so may require separate treatment.

Voting eligibility

106. The Companies Act does not prescribe eligibility to vote on scheme or amalgamation proposals although Courts may do for schemes of arrangement where different classes of interested person are involved. The Code, where shareholder votes are involved, generally precludes the involvement of both direct transaction participants and their associates.

107. The Code’s associate and involvement rules do not work as an analogy for a scheme or amalgamation because under the reconstruction provisions all shareholders are involved. That involvement would preclude them from a rule 7(c) or 7(d) vote under the Code. So the Code’s rules around voting eligibility cannot simply be transcribed into Parts 13 and 15 of the Companies Act.

108. One possibility would be to exclude from voting on a scheme or amalgamation the voting rights attached to shares held by parties associated with the formulation and promotion of the proposal, likely to be the largest shareholders. To be consistent with Companies Act philosophy this could be a requirement for approval (at more than 50% of those voting, that is, by ordinary resolution) of the proposal by the remaining, and therefore non-interested, shareholders.

109. Pulling these two issues (of voting thresholds and shareholder information) together suggests six sub-options. That is, the following three options could be with *or* without separate approval by ordinary resolution of non-interested shareholders. All six sub-options would include a requirement that the scheme or amalgamation proposal

provided to shareholders must contain the same information as would be provided in respect of a Code offer.

Information disclosure

110. The information that would be required to be provided to shareholders, in addition to the broad requirements contained in Parts 13 and 15 of the Companies Act, would include:

(a) an independent report for shareholders on the merits of the transaction, to be prepared by an independent adviser approved by the Panel

(b) disclosure of key assumptions used in the valuation of any asset or prospective financial information about the target company

(c) disclosure about which shareholders have already agreed to vote in favour of the proposal, the material terms of the agreement, and details of the ownership of equity securities in the amalgamating companies by the directors of the companies involved in the proposal and by all substantial security holders of the companies involved in the proposal (i.e., by those holding or controlling 5% or more of the shares)

(d) disclosure about the persons involved in the formulation of the proposal, and their and their associates' ownership of voting securities in any of the companies involved in the proposal

(e) for an amalgamation or scheme with the type of transaction described in paragraph 113(b) below, a statement of the general nature of any material changes likely to be made to the business activities of the amalgamated company and its subsidiaries, if the proposal is approved by shareholders.

Option 3A Approval level set at 50% of voting rights

111. For the approval threshold to be universal, and consistent with the Code's requirement for control, an appropriate approval threshold could be a positive vote representing more than 50% of total voting rights of the target company.

Option 3B Approval level set at 75% of voting rights

112. Approval by Option 3A's 50% of total voting rights, for what is effectively a compulsory acquisition, might be considered too light, while a requirement for approval by 90% of total voting rights might be considered impossible to achieve. Therefore, a median-ranged percentage, such as 75% of total voting rights, might be considered the most appropriate equivalence to the Code thresholds.

Option 3C Approval level set by type of takeover

113. If the approval thresholds were to be tailored to the particular type of transaction, and prescribed in law, the following gradations in approval levels might be appropriate (in conjunction with a special resolution of each company):

(a) for a full cash takeover, or where scrip is being provided as consideration and the target company shareholders become very minor shareholders in the bidding company, by a 90% majority of total voting rights of the target company

(b) for a merger of shareholders, where the shareholders in the participating companies will end up with a control influence in the continuing company roughly proportionate (taking account of the dilutionary effects of the amalgamation) to their former position in the amalgamating companies, a 50% majority of total voting rights, for each of the companies involved in the proposal

(c) for a reconstruction involving no or minimal change in effective control, no special voting requirements other than the usual special resolution.

114. Selecting the appropriate alternatives, especially in complex transactions, would involve value judgements, and thus some authoritative exercise of discretion to determine which category a proposal should fall into. A mechanism (such as the Court's discretion, the Panel's discretion, or some other body's discretion) would be required to fill this role.

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

115. A fourth alternative would be to amend the reconstruction provisions of the Companies Act so that amalgamations under Part 13 of the Companies Act cannot be undertaken at all if a Code company is involved. This would move the statutory regime in New Zealand closer to that in Australia, where amalgamations cannot be used for mergers involving Code companies.

116. Schemes would be available where changes of control of Code companies are involved. Therefore, this option could be implemented in conjunction with either Option One or Option Three in respect of schemes.

117. It would mean that if bidders wish to achieve a change of control of a Code company by takeover they would have to use the mechanisms under the Code or the scheme mechanism under Part 15 of the Companies Act (as amended for Option 1, to ensure that shareholders would not be disadvantaged by the use of a scheme instead of a takeover made under the Code).

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

118. A final alternative considered here would be to amend the reconstruction provisions of the Companies Act 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 in circumstances where the use of the reconstruction provisions was clearly warranted.

119. It would mean that if bidders wish to achieve a change of control of a Code company they could only use the takeover mechanisms under the Code, unless otherwise permitted by the Panel.

Postscript to consideration of options

120. One other matter, in respect of which the Panel would like the market's view, is the appropriateness of the Code's 90% compulsory acquisition threshold. Has it created the incentive for companies to utilise the Companies Act reconstruction provisions instead of the Code for control-change transactions because 90% is considered too hard to achieve or unreasonable? The Panel would like to test the idea as to whether reducing the Code's compulsory acquisition threshold would encourage greater use of Code takeovers.

121. Would it be sensible to lower the Code's compulsory acquisition threshold to:

(a) 85% of total voting rights in the Code company?

(b) 80% of total voting rights in the Code company?

(c) 75% of total voting rights in the Code company?

122. The Panel is not proposing this as an alternative option to the options set out above. But it would like market participants' views as to whether a reduction in the Code's compulsory acquisition threshold could improve (or harm) the effectiveness of the Code.

Summary assessment of the options

Table 3. Summary assessment of the options vs. Status Quo					
Objectives	**1. 'Anti-avoid-ance of Code' provision in Companies Act**	**2. Exempt from Code**	**3. Bolster Companies Act**	**4. No Part 13 Amalgamations**	**5. No Part 13/15 for Code Companies**
Efficient allocation	Should improve information.	Little effect. Panel activism may improve information.	Little effect. Should improve information.	Little effect: firms can switch to 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.	Potential deterioration as certainty could encourage greater use of reconstruction provisions.	Potential improvement if threshold and/or information changes improve participation.	Marginal improvement, if it raises the test for compulsory acquisitions under amalgamations (under either Code or Court-approved scheme).	Improvement as all takeover proposals involving Code companies would be subject to Code.
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.	Potential deterioration, as it may increase the perception of risk, but greater certainty of available routes allows least cost option to be chosen.	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.	Potential for some deterioration if greater use of reconstruction provisions.	Improvement through changes in voting thresholds when Code companies are involved.	Potential improvement for amalgamations, but potential to switch to Part 15 provisions.	Improvement through changes in voting thresholds when Code companies are involved.
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.

5. YOUR FEEDBACK

The Panel welcomes your feedback on this paper. A questionnaire is provided beginning on page 32.

You can complete and submit the questionnaire on line at www.takeovers.govt.nz.

Alternatively you can download a Word version of the questionnaire from the website to complete and send:

- **by email** - takeovers.panel@takeovers.govt.nz
- **by post** - Takeovers Panel
Level 8 Unisys House,
56 The Terrace,
P.O. Box 1171,
WELLINGTON;
- **by fax** - +64 4 471 4619.

The closing date for submissions is 15 February 2008.

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

QUESTIONNAIRE

Problem definition

A. Do you agree that there is a problem? Please explain, considering:

(a) Is the use of the reconstruction provisions to effect changes of control of Code companies likely to become more or less frequent under the current legal situation?

(b) What are the consequences for shareholders and for market integrity, if any, of takeovers or mergers involving Code companies being conducted under the reconstructions provisions, and how significant are these?

(c) Is the information disclosed to shareholders under the Code, amalgamation, or scheme requirements materially different, and if so how might it affect decision-making for shareholders?

(d) Should the rights and protections of the Code apply to all changes of control of Code companies irrespective of the manner in which the change occurs? Why, or why not?

Comment:

Policy objectives

B. Are the stated policy objectives appropriate for assessing how alternative solutions for effecting changes of control of Code companies should be measured?

Comment:

C. Are there other objectives which you think should be included for the assessment referred to in Question B, or should some of the objectives used in this discussion document be excluded? Why?

Comment:

D. Are some objectives more important than others? Why?

Comment:

Options

E. Are there any other options you believe the Panel should consider? What are they and why should they be considered?

Comment:

F. Do you agree with the Panel's assessment of the impact of the options? If not, what would your assessment be and why?

Comment:

G. What option do you prefer and why?

	Yes	No		Yes	No
No Change					
Option 1: Anti-avoidance provisions included in Parts 13 and 15 (can't undertake amalgamation or scheme to avoid Code)			… and increase the enforcement role of the Panel and the Companies Office.		
Option 2: Carve out from Code					
Option 3A. Set Companies Act approval level at >50% of total voting rights			… and a separate ordinary resolution of non-interested shareholders.		
Option 3B. Set Companies Act approval level at 75% of total voting rights			… and a separate ordinary resolution of non-interested shareholders.		
Option 3C. Set Companies Act approval level by type of transaction outcome			… and a separate ordinary resolution of non-interested shareholders.		
Option 4. Prohibit Part 13 Amalgamations					
Option 5. Prohibit Part 13 and 15 reconstructions involving Code companies unless permitted by Panel					

Other

Comment:

H. (Postscript to options consideration) Please provide comments on the Panel's question as to whether the Code's 90% compulsory acquisition threshold should be lowered. In particular:

(a) does the 90% threshold cause (or significantly contribute to) the utilisation of the Companies Act reconstruction provisions in a manner that avoids the Code?

(b) would reducing the Code's compulsory acquisition threshold increase the attractiveness of using the Code for takeover transactions?

(c) would reducing the Code's compulsory acquisition threshold damage the integrity and objectives of the Code?

(d) If the threshold were to be reduced, what would be the appropriate threshold (please explain the reasons for the level you would choose):

- 85%?
- 80%?
- 75%?

Comment:

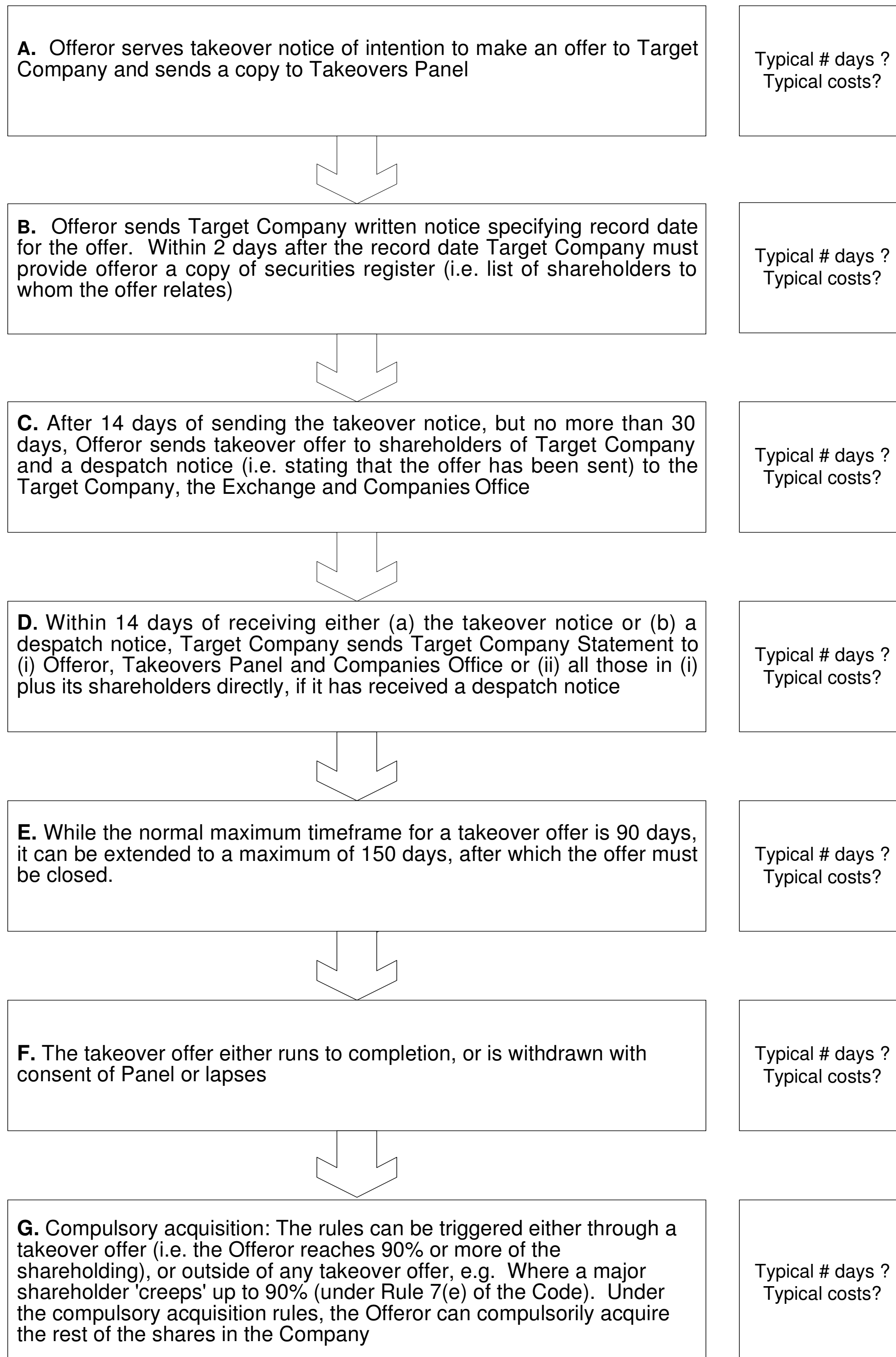
I. Can you provide any cost information to compare the costs of compliance of a Code takeover versus a scheme of arrangement or amalgamation? Please identify any sensitive information for OIA purposes. In particular:
   - (a) What might be typical legal and other advisers' fees that are paid by the parties under a Code offer, an amalgamation, or a scheme?
   - (b) Is there typically a difference in the distribution of the costs between bidders and target company and its shareholders depending on the vehicle chosen?
   - (c) Do the different vehicles impose differences in staff, management and board time that must be dedicated to preparing and effecting a takeover?

Comment:

6. APPENDIX

CODE TAKEOVER

This flowchart assumes that the offeror and/or target company are listed on the exchange. It is a simplified takeover process and as such does not cover all variations that may occur in a takeover process.



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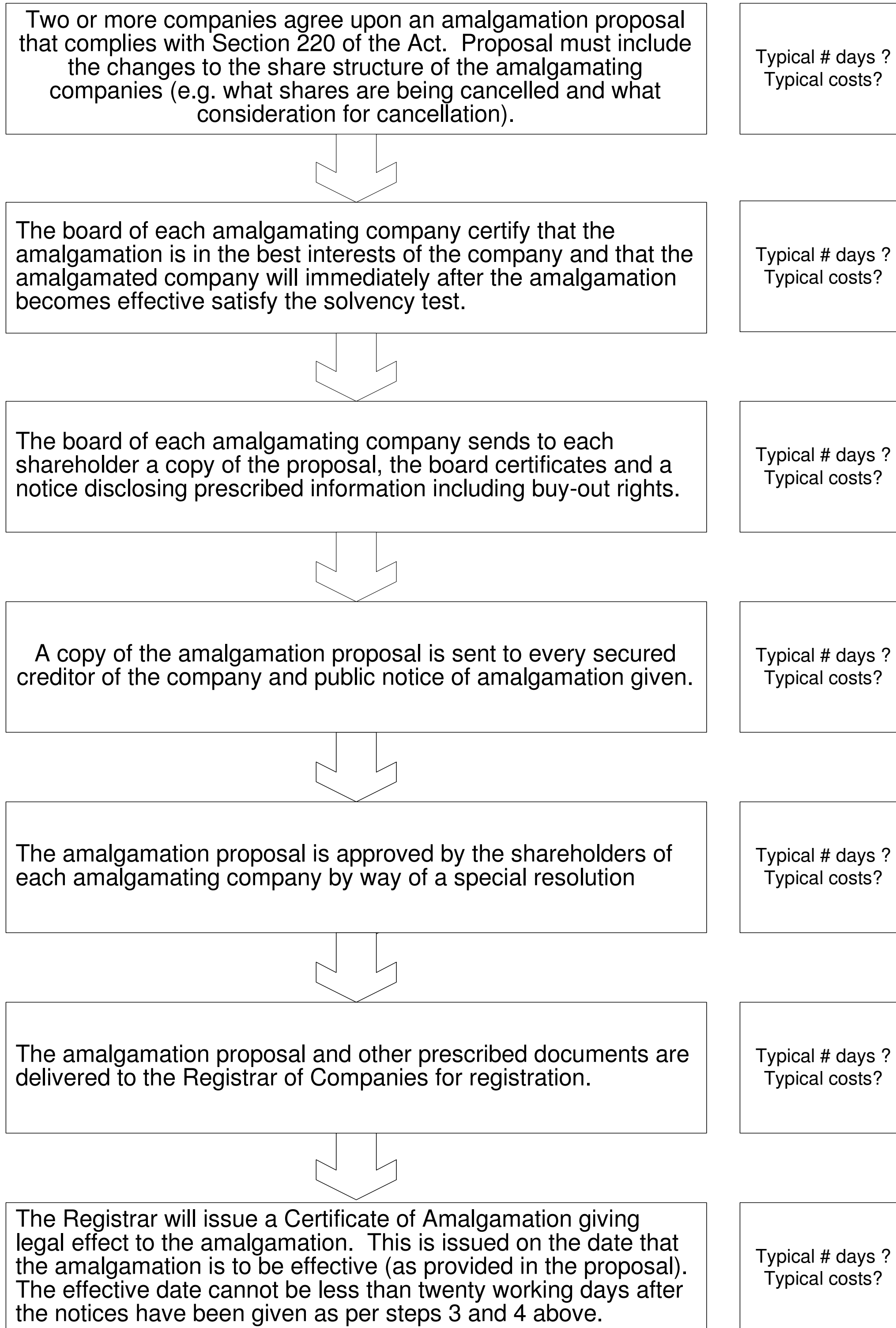
AMALGAMATION



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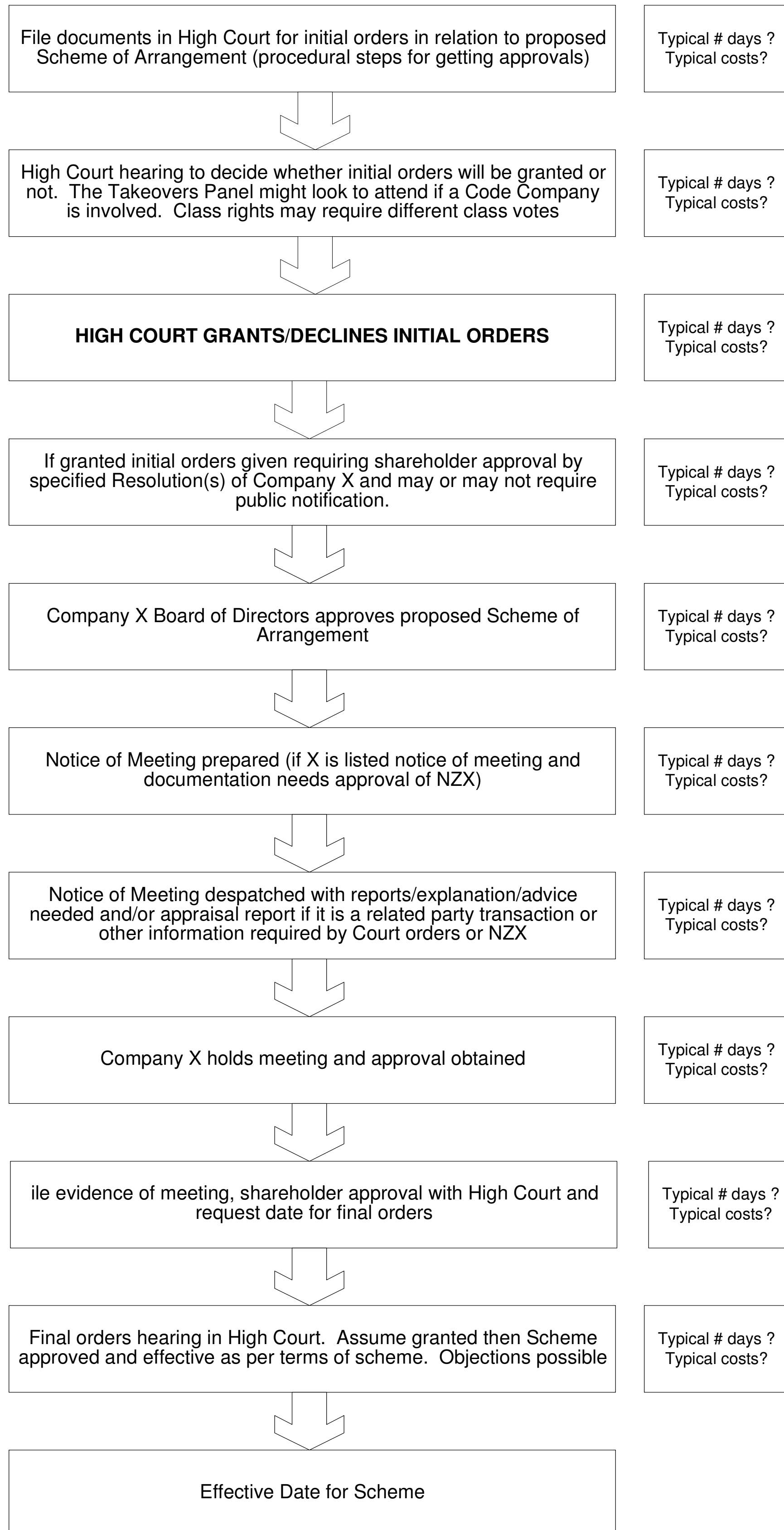
SCHEMES OF ARRANGEMENT



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