RECOMMENDATIONS TO THE MINISTER OF COMMERCE BY THE TAKEOVERS PANEL

PROPOSAL

1. The Takeovers Panel proposes changes to the Companies Act 1993 and Takeovers Act 1993 so that it would only be possible to use the scheme of arrangement provisions in Part 15 of the Companies Act to effect a change of control of voting rights in a Code company, instead of using the Takeovers Code, if there would be no adverse effect on shareholders from Part 15 being used. The Panel would have a role to provide 'no objection' statements for use by the promoters of the scheme in Court under Part 15. If the Panel provided a no objection statement, the transaction would be exempted from the Takeovers Code.

2. The Panel supports the continued availability of Part 15 of the Companies Act for effecting changes of control of Code companies because Part 15 provides a legitimate and flexible legal vehicle for complex transactions. The proposal achieves this while also improving fairness for shareholders, legal certainty, and market integrity.

BACKGROUND

3. The Panel has become aware of a number of cases where amalgamations and schemes have been undertaken under the Companies Act instead of under the requirements of the Code. The avoidance of the Code in this manner could have an adverse impact on the perception of the integrity of the New Zealand market.

4. On 27 March 2007 you asked the Panel to advise on the issue of amalgamations and schemes of arrangement under the Companies Act (the "reconstruction provisions") involving companies that fall under the Takeovers Code. This followed the Panel's June 2006 discussion paper on the matter, and the Panel's subsequent recommendations to you and the Commerce Committee when it was considering the 2006 Business Law Reform Bill.

5. In response to your request the Panel issued a new discussion paper on 5 December 2007 to seek the market's views on the Panel's assessment of the issue and on the merits of a number of options outlined in that paper. 16 submissions were received by the deadline of 15 February 2008.

DISCUSSION

6. The attached Regulatory Impact Statement describes in detail the nature of the issue under the status quo and the options that have been considered.

7. To date there have been some instances of the reconstruction provisions being used to avoid the more stringent requirements of the Takeovers Code. These have been high profile, attracting considerable media attention.

8. The concern tends to be that some shareholders, particularly those whose shares are compulsorily acquired, may be adversely affected, and that not using the Code undermines the integrity of the market and thus may discourage investment. There is no evidence whether shareholders were or were not adversely affected in those instances but the perception remains.

9. Our analysis and the overall sentiment from submissions have led us to conclude that, as the reconstruction provisions are being used for up to approximately 14% of takeovers involving Code companies, change is warranted because:

   (a) *perceptions* about market integrity and procedural fairness may be more important as an influence on market activity than the reality;

   (b) there is no disagreement that the Companies Act and Takeovers Act are at odds with each other, which creates confusion and legal uncertainty;

   (c) there is a risk that the use of the reconstruction provisions will increase if this is not addressed;

   (d) it is worthwhile avoiding the risk that this practice turns into a problem in future, as long as the costs of legislative change are small; and

   (e) as a result of the change, New Zealand legislation related to takeovers aligns more closely with that in Australia.

10. The proposal is to amend the Companies Act 1993 to:

   (a) permit the use of the Part 15 scheme provisions for effecting changes in control of Code companies only if the Court is satisfied that the use of Part 15 (instead of the Code) will not adversely affect shareholders, or if the Panel provides a 'no-objection' statement

   (b) stipulate shareholder approval thresholds when Part 15 is used

   (c) codify the common law principles for determining interest classes in which shareholders vote on the scheme proposal

   (d) preclude the use of the Companies Act Part 13 section 221 amalgamation process where a Code company is involved.

11. As outlined in the attached Regulatory Impact Statement this combination of changes improves the fit between the Companies Act and Takeovers Act, while retaining the flexibility of being able to use Part 15 for schemes and amalgamations to effect control changes of voting rights in a Code company. The option is closely aligned with Australian law, which is reported to work well.

12. There would be some consequential amendments to the Takeovers Act and the Code. The Takeovers (Fees) Regulations 2001 would also need to be amended so that the Takeovers Panel can charge promoters of the scheme a fee for the giving of 'no objection' statements.

FINANCIAL IMPACT

13. The proposal may increase the costs to promoters of a Part 15 scheme, although it would appear that the cost impact is small if not negligible; promoters of a scheme must already provide shareholders with sufficient information to meet the current statutory requirements, and the costs of undertaking a change in control are driven more by the complexity of the transaction itself than by the legal vehicle used to achieve the control change.

14. The preferred option envisages an expanded role for the Takeovers Panel in giving 'no objection' statements. In the initial set-up phase, the Panel will need to develop policies and procedures to assist its decision-making on when it would give, or decline to give, a no objection statement, and to assist the market on how to make applications for a no objection statement. The Panel believes that it would require additional funding of approximately $X in the first year for set up costs with on-going additional funding per annum of approximately $X in the first year and in out-years, to provide for up to one additional FTE for the non cost-recoverable work associated with Part 15 schemes. The Panel already has access to the use of its Litigation Fund for appearing in Court for schemes and does not envisage the need, at this point, for the Litigation Fund itself to be increased.

CONSULTATION

15. The Takeovers Panel has consulted with the market in 2006 and again in December 2007. 16 submissions on the latest paper were received by February 2008. 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 under the current arrangements. We believe that the preferred option retains much (although not all) of the flexibility of the status quo, while improving the fairness of the process for shareholders. Several submitters indicated that, if option 1 (as set out in the RIS) were chosen, clear identification of interest classes for shareholder voting would be necessary. This has been reflected in the preferred option.

RECOMMENDATIONS

16. In accordance with section 8(1)(a) of the Takeovers Act 1993, and having considered the submissions received on the 2007 discussion paper, the Panel recommends that the following changes be made to the Companies Act 1993:

    (a) A provision should be inserted into Part 15 of the Companies Act, under which the Court would be prevented from approving a scheme that would have any effect on the voting rights of a Code company unless:

        - the Court is satisfied that the shareholders of any such Code company would not be adversely affected by the transaction not being undertaken under the Takeovers Code, or

- there is produced to the Court a statement in writing by the Panel stating that the Panel has no objection to the amalgamation or arrangement;

However, the Court need not approve a scheme even though a statement by the Panel, stating that the Panel has no objection to the scheme, has been produced to the Court;

(b) Voting thresholds, for the shareholder resolutions to approve of the scheme are stipulated, so that for the resolution to be passed –

(i) Those voting in favour represent 75% of the votes cast on the resolution at each meeting of shareholders (see sub-paragraph (c) below); and

(ii) Those voting in favour represent a majority of the shares eligible to be voted (i.e., more than 50% of total voting rights of the company);

(c) The voting threshold in sub-paragraph (i) must be obtained at each meeting of each group of shareholders (as determined by the Court under section 236(2)(b)of the Companies Act as being an interest class for the purposes of voting on the resolution);

(d) Guidance for the Court should be included in Part 15 of the Companies Act on how to determine interest classes, for example by codifying (to some extent) the principles of the common law for determining those classes;

(e) The use of the Companies Act's Part 13 long form amalgamation, under section 221, should be prohibited where an amalgamating company is a Code company, but the availability of the short form amalgamation under section 222 should be preserved for all companies.

17. The Panel also recommends that the Takeovers Act and the Code should be amended:

(a) to provide a statutory exemption from the application of the Code where Code companies are involved in a scheme of arrangement under Part 15 of the Companies Act if the Panel has provided a 'no objection' statement for production to the Court; and

(b) as appropriate, and consequential to the proposed amendments to the Companies Act, in order to ensure that the Panel has all the necessary statutory functions and powers to undertake the role proposed in these recommendations.