

Takeovers Update

AUGUST 2010

Takeovers Panel's proposals for amalgamations and schemes of arrangement by "code" companies are underway

BACKGROUND

After a period of relative silence on the topic following considerable debate during 2006 to 2008, the Minister of Commerce last week announced that the parts of the Companies Act relating to schemes of arrangement and amalgamations for companies subject to the Takeovers Code ("code companies") will be amended to better align them with the Takeovers Code regime.

In the past, the Takeovers Panel has expressed its concern about the use of amalgamations and schemes of arrangements under the Companies Act as an alternative to a takeover offer made under the Takeovers Code. It has been pressing for legislative reform to address that concern. The Government's latest announcement picks up on the recommendations made by the Takeovers Panel to the Labour Government in 2008.

THE PROPOSED CHANGES

The Minister of Commerce has recommended to Cabinet that it approve the changes to the Companies Act relating to schemes of arrangements and amalgamations proposed by the Takeovers Panel in 2008. Those proposed changes were:

- **Part 13 amalgamations prohibited:** The use of long-form amalgamations under Part 13 of the Companies Act will be prohibited where an amalgamating company is a code company. Short-form amalgamations (i.e. for intra-group reorganisations) will still be permitted.
- **Court process to be more aligned with Takeovers Code requirements:** The Court must only approve a scheme that would have any effect on the voting rights of shareholders in a code company if:
 - the Court is satisfied that the shareholders of that code company would not be adversely

affected by the transaction not being undertaken under the Takeovers Code; or

- the promoters of the scheme produce to the Court a "no-objection" statement from the Takeovers Panel. The Panel has indicated that the criteria for issuing a "no-objection" statement will include, among other things, that an independent adviser's report has been provided to shareholders.

The Court will retain its discretion to not approve a scheme even if a "no objection" statement is provided by the Takeovers Panel.

- **Codification of interest class tests:** Legislative guidance will be provided to the Court for determining interest classes for the purposes of voting on a resolution to approve a scheme of arrangement. This would be done by codifying current common law principles.
- **Two limb voting test (75% approval by each interest class and approval by 50% of the total eligible voting rights):** The following two-fold voting threshold will be stipulated for shareholder resolutions to approve a scheme:
 - those voting in favour represent at least 75% of the votes cast on the resolution by each interest class of shareholders; and
 - those voting in favour represent more than 50% of the total voting rights in the code company (i.e., not just 50% by number of those voting on the resolution). This second limb applies on an overall basis rather than by each interest class separately.
- **Exemption from Takeovers Code for Court-approved schemes:** If the Court approves the scheme, then the code company would be exempt from the application of the Takeovers Code.

KEY ISSUES IN RELATION TO IMPLEMENTING THE CHANGES

Codification of interest classes

How the principles for determining interest classes are codified will be critical to the potential usefulness of schemes for undertaking transactions involving a change of control in a code company. As approval is proposed to be required from each interest class separately, a codification which too readily finds separate interest classes may result in schemes being considered commercially unattractive given the multiplicity of separate approvals that could be required and the power this would potentially provide to minority shareholders to determine the ultimate outcome of the approvals.

Appropriateness of the 50% of total voting rights threshold

We believe that the legislators need to think carefully about the changes that are intended here. The requirement for 50% of total voting rights (as opposed to votes cast) potentially puts a scheme transaction out of reach for widely held public companies, where voter turn-out on even highly publicised resolutions can be in the 30%-40% range. That would be an unfortunate outcome which the law makers should be careful to avoid.

Voting undertakings

One potential countervailing provision that we think the legislators should adopt is a concept that permits the promoter of a scheme to seek binding voting undertakings from major shareholders to vote in favour of the scheme. This would give scheme promoters confidence that they can commit the significant resources necessary to undertake the scheme transaction and announce it to the market safe in the knowledge that certain larger shareholders are supportive. No public policy purpose is served by that issue being a mystery to the bidder until months later, on voting day.

Such an undertaking can be obtained under the UK Takeovers Code on the basis that, in a scheme context, such an undertaking is, in substance, the equivalent to a lock-up. Lock-ups are permitted under the New Zealand Takeovers Code, but the Takeovers Panel has

in the past viewed a binding voting commitment as the beneficiary of the commitment having control over voting rights and, if those voting rights exceed 20%, that would be a breach of the Takeovers Code. If the approach we suggest is adopted, we also believe:

- the guidance on interest classes should expressly provide that shareholders who provide a voting undertaking do not, by that act alone, constitute a separate interest class; and
- the Takeovers Panel should issue guidance approving the use of such voting undertakings – similar to that issued by the UK Takeovers Panel, where such undertakings are seen as being logically consistent with the traditional form of lock-up.

Criteria for Takeovers Panel to issue a “no objection” statement

The criteria the Takeovers Panel will apply before issuing a “no objection” statement to the Court will also be important. If this is too onerous, it may dissuade potential promoters from structuring a transaction in this manner. Market participants will also want this criteria to be as standardised as possible so that parties are aware of the likely process for, and costs of, undertaking a scheme – i.e. there should be specified criteria, with exemptions for certain aspects granted on a case-by-case basis if appropriate.

Proposed extent of Takeovers Panel involvement in scheme process

Market participants will also be keen to understand the degree of interaction that the Takeovers Panel expects to have with parties during the scheme process.

IMPLICATIONS FOR PRACTICE

Assuming that the Takeovers Panel’s proposed changes come into effect as law, the key implications for practice will be:

- **Two choices of transaction structures:** The choice of transaction structure for changes of control of code companies will be limited to:
 - contractual offers under the Takeovers Code – supervised by the Takeovers Panel; and
 - Court-approved schemes of arrangement under Part 15 of the Companies Act – with likely Takeovers Panel involvement through the “no objection” process.

It will still be possible to undertake an amalgamation involving a code company, but that must be done under Part 15 rather than Part 13 of the Companies Act.

- **Mandatory independent adviser's report:** An independent advisor's report will be required for any transaction involving a change of control in a code company.
- **Ensuring requisite level of shareholder support is obtained:** Greater efforts may be required to encourage shareholders to vote in relation to a scheme to ensure that the 50% threshold (of those eligible to vote) is reached. This will be a particular issue for companies with widely held share registers. This may require greater use of advertising campaigns, proxy solicitation and broker handling fee-type arrangements.
- **Stakebuilding:** Because of the interest class voting arrangements, stakebuilding may be of little benefit in connection with a scheme (other than for the purpose of acquiring a potential blocking stake to prevent another party from getting to the 90% compulsory acquisition threshold). In fact, stakebuilding may actually be detrimental in certain circumstances as it may magnify the stake of any dissenting shareholders.

TIMING AND NEXT STEPS

The changes are likely to be implemented through legislation to be introduced next year. Given the significance of these changes for code companies, we expect interested parties will be given an opportunity to make submissions on the legislation at the select committee stage.

If you would like further information on the proposed changes, please contact your usual Bell Gully adviser or:

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