

SCHEMES OF ARRANGEMENT AND AMALGAMATIONS INVOLVING CODE COMPANIES

QUESTIONNAIRE & SUBMISSION

This submission is prepared by Bell Gully in response to the Takeovers Panel's Consultation paper and follows the form of the questionnaire provided in that paper.

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:

Do you agree that there is a problem?

We do not believe there is a problem with the status quo. We disagree with the central premise of the discussion paper that the use of Parts XIII and XV of the Companies Act to effect changes of control of Code companies is a problem. Rather, we believe that the current system allows commercial parties to match the appropriate mechanism with the appropriate type of transaction.

Some transactions are more appropriately structured as takeovers and some are more appropriately structured as Court approved schemes of arrangement (**Schemes**) or amalgamations. The choice of transaction structure can depend on many factors including:

- the intentions of the bidder and the target;
- what each of them wishes to achieve;
- whether the transaction is friendly or hostile;
- whether an absolute "all or nothing" outcome is required or whether there is more flexibility as to the outcome;

- whether there are various categories of securities other than shares (e.g. debt securities, convertible securities, options) that can more readily be replicated, modified or reconstructed under a scheme;
- whether there are various categories of holder to whom different types of consideration are attractive and whether different types of consideration can best be catered for under a takeover, an amalgamation or a scheme.

For merger and acquisition transactions involving Code companies, the number of takeovers under the Code has significantly outweighed the number of schemes and amalgamations. In our view schemes and amalgamations are used considerably less frequently as merger and acquisition structures in New Zealand compared with the frequency of their use in Australia and the United Kingdom (see our comments below).

We believe that transactions involving votes by shareholders to approve transactions between companies, such as in amalgamations and Schemes, are regulated adequately by the Companies Act and, in the case of schemes, the High Court's supervisory jurisdiction under that Act. Those Companies Act regimes have been in force for many years and have operated without difficulty.

Far from posing a problem, we believe that transactions under the reconstruction provisions, under Part XV in particular, offer real benefits when compared with transactions under the Code. For the relevant company, schemes and amalgamations can offer an added level of security because they may only proceed with the support of the Board of the target company. It is not realistically possible to undertake a "hostile" amalgamation or scheme. Whereas hostile takeovers are relatively common. Moreover, schemes offer efficiency gains on both sides of the process by allowing multiple transactions to be packaged in one scheme, requiring only one vote or one meeting at which all necessary votes are undertaken.

Worldwide, schemes are not only accepted as useful and fair transaction structures, but are also fast becoming a structure of choice. We believe that schemes are respected and efficient instruments that are increasingly relied upon in cognate jurisdictions such as Australia and the United Kingdom. It is important that New Zealand remains in step with international practice so as to ensure the international competitiveness of our capital markets.

The Australian Securities and Investments Commission (ASIC) has taken a 'hands-off' approach to regulation by relying on the court process set down in the relevant legislation (The Corporations Act). This regard for the court process has created an environment of confidence where schemes are used freely – indeed, more than half of M&A transactions in Australia are now completed by way of a scheme¹.

Similarly, in the United Kingdom schemes accounted for six of the seven largest transactions during the first six months of 2007. In that jurisdiction the development of court and Panel practice has led to robust and trusted oversight of such transactions without undue interference².

¹ "Schemes of Arrangement; A Convenient Truth" Australian Legal Business iss. 5.3

² Malcolm Lombers and Andy Radford "London's Scheming", The UK Takeover Panel takes a flexible approach to schemes of Arrangement Int. Financial Law Review July 2007.

The world-wide acceptance of schemes is further highlighted by the recent announcement of BHP Billiton's offer for Rio Tinto which involved multiple jurisdictions which expressly reserves the right to proceed by way of scheme of arrangement³.

The Panel has commented in the consultation paper about the concern among some market participants in relation to the Waste Management/Transpacific amalgamation. In our view the concerns expressed in relation to that transaction were, to some degree, those of specific stakeholders, some of whom had ulterior motives behind the concerns they voiced. For example, some of the more vocal critics of that proposal were minority shareholders who would have had a greater ability to exert leverage or attempt to “greenmail” a takeover offeror into increasing its price. The amalgamation structure used in that transaction provided an all or nothing outcome for shareholders (at a price unanimously supported by the Board and **above** the high point of the independent expert's value range). In the amalgamation, those minority shareholders did not have the same undue leverage or greenmail opportunity to extract an increase in the consideration proposed.

Furthermore we believe that the vocal concerns expressed in relation to the Waste Management transaction (many by stakeholders with the kinds of motives outlined above) were not representative of the wider views of Waste Management shareholders or market participants as a whole. Stakeholders who are happy with a particular transaction tend not to be vocal – they do not have the same motivations to express their views publicly. Ultimately the overwhelming shareholder approval for the Waste Management transaction (and very low level of votes against) was evidence that the vocal concerns expressed by a few were not representative of the views of the vast majority of shareholders. It should not be overlooked that all shareholders had an unfettered opportunity to vote against the transaction (simply by ticking a box and returning a form) and only a very small percentage did.

Another element to the all or nothing outcome of an amalgamation (which applies equally to a scheme) which was relevant in the Waste Management case was that the amalgamation structure could not have resulted in Waste Management becoming a partly-owned subsidiary of a competitor (Transpacific). Waste Management had for many years until 2000 been a partly owned subsidiary of Waste Management Inc., of the USA which had its own separate subsidiary operations elsewhere, particularly in Australia. That ownership structure had inhibited Waste Management's ability to grow. The group of which it was part already had operations in countries Waste Management could realistically expand into, with the result that the partially owned Waste Management was essentially restricted to its home country (New Zealand). A takeover by Transpacific could equally have resulted in partial ownership by a competitor and the possibility of Waste Management again being confined in its ability to grow and expand within such an ownership structure. An amalgamation of the kind used could only result in a 100% business combination and the creation of one overall merged company. A takeover could easily have resulted in partial ownership of anywhere between 50-90%.

The Panel's document appears to disregard the high proportion of votes cast in favour of schemes, focussing instead on the lack of threshold for participation. The reasons why less than half the total votes are often cast at meetings to approve schemes are numerous, ranging from shareholder apathy to internal policy restrictions adopted by foreign institutions over the exercise of voting rights for tax and other reasons. Moreover, schemes are typically approved by between 95 and 99% of the total votes cast, reflecting a very high level of shareholder support for sensible and beneficial transactions. Schemes that are not favoured

³ BHP Billiton press release 6 February 2008 (para 4).

by shareholders are usually withdrawn before they reach the voting stage.

(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?*

We believe it is likely that commercial parties will continue to use Part XIII and Part XV in appropriate circumstances. We see no particular reason for their use to become either more or less frequent, although the recent international experience referred to above may indicate an increasing awareness of the benefits of Part XV type transactions in particular.

(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?*

We believe the use of Part XV to effect changes of control is likely to enhance market integrity given that:

- Schemes are necessarily conducted with the co-operation of the “target” company board and are therefore consensual arrangements under which the directors of every relevant company have determined that the transaction is in the best interests of the company and its shareholders.
- Schemes are conducted under the well-established procedures developed by the High Court. The Court’s role and expertise in supervising schemes, and in ensuring that the interests of shareholders are protected, is respected by the market.
- Schemes are widely used in other jurisdictions and international investors are familiar with their use in change of control transactions.

We believe that market integrity is likely to be undermined by a procedure in which the Panel is in a position to make decisions on a case by case basis without clear criteria by which those decisions are to be made. That would inevitably create unpredictability and market uncertainty and would therefore be likely to damage market integrity.

(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?*

We are aware from the consultation document that the Panel is concerned about the absence of mandated information requirements under Part XIII and Part XV transactions. We believe that concern is overstated and overlooks the practice that has developed, under the supervision of the Court, under which shareholders are provided with very full information including, where appropriate, independent expert advice. Under a Part VI transaction, the Court generally requires to review this material before it is delivered to shareholders to satisfy itself that the information fully and fairly informs shareholders of the proposed transaction. It is our experience that judges do scrutinise the material that goes to shareholders, and often direct that additional information or statements are added. Often these documents take the form of prospectuses and investment statements that are reviewed by the Companies Office. Invariably investors receive a report from an independent expert commenting on the merits/disadvantages of the scheme. Although Part 13 amalgamation transactions do not require Court supervision, the practice in relation to amalgamations has also been for shareholders to be provided with very full information, including an independent expert’s report. The information provided in relation to Part 13 and

Part 15 transactions involving listed Code companies must satisfy not only the requirements of the Companies Act but also the NZSX Listing Rules and is subject to review and approval by NZX before it is sent to shareholders. We do not therefore believe that there is any material difference in the nature of information provided to 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?*

No. We believe the Code should apply only to those transactions for which it was intended. There was no suggestion that the Takeovers Act or Code should apply to all changes of control during the various reports and parliamentary debates surrounding its introduction and it is clear that the Code was not intended to interfere with transactions conducted under the separate regimes in Parts 13 and 15 of the Companies Act. As the Court of Appeal noted in *Dominion Income Property Fund Ltd v. Takeovers Panel*, a Part XV arrangement is generally not a “takeover” within the meaning of that term in the Takeovers Act or Code and Part XV has its own regime of safeguards which, while different from those in the Code, provide sufficient and in some respects superior protection for shareholders.

Policy objectives

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

Comment:

We believe the section 20 objectives identified by the Panel are all appropriate from a policy perspective. We also believe that the current array of mechanisms under the Takeovers Code and the Companies Act support rather than undermine those objectives. We believe that schemes and amalgamations assist New Zealand’s capital markets to maintain their international competitiveness. We also contend that the flexibility they provide contributes to market participation and therefore to competition and allocative efficiency. We agree that fair treatment of shareholders (both target shareholders and shareholders of acquirors) is an important objective and contend that the Companies Act procedures ensure fair treatment of shareholders through the dual oversight of Boards of Directors and the courts (as noted by the Court of Appeal in *Dominion Income Property Fund Ltd v. Takeovers Panel*).

B. 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:

We believe the objective of maintaining a range of flexible and appropriate mechanisms for changes of control is of paramount importance. Currently, Part XV is the only practical means of effecting certain types of reconstructions, including demergers and capital reductions. To regulate this capacity away would damage the capacity of companies to take the appropriate decisions at the appropriate times.

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

Comment:

We do believe it is appropriate to attribute greater significance to some objectives over others. Each will be important to varying degrees in particular situations. We believe the flexibility and responsiveness of the various reconstruction options available under the current regime allows those objectives to be met.

We consider that a shift away from the status quo as mooted by the Panel would be likely to frustrate a number of the objectives. This is particularly true of objectives 1 and 2, where the range of options available to market participants is crucial to competition for control and to the efficient allocation of resources. Further, fair treatment and autonomous decision-making may be compromised by reforms that would disproportionately empower minority interests.

Options

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

Comment:

We disagree with the premise that there is a “problem” and do not therefore believe it is necessary to consider other options.

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

Comment:

We disagree in the following respects:

Efficient allocation: A competitive market for control of code companies facilitates the efficient allocation of resources. All the proposed options would, in some circumstances, make change of control transactions more difficult to undertake and would therefore prevent or discourage efficiency improving transactions. The Panel’s summary of impacts fails to acknowledge this negative consequence.

Competition for control: By making change of control transactions more difficult to undertake, all of the proposed options would reduce competition for control.

Fair treatment: We do not believe that any of the proposed options would improve the “fair treatment” of shareholders and consider that the Panel’s comments on this issue are based in the incorrect premise that amalgamations or schemes of arrangement treat shareholders unfairly. We also believe it is wrong to equate a higher compulsory acquisition threshold as improving the fair treatment of shareholders. In many situations, allowing a small minority of shareholders to block a transaction that is supported by the vast majority of shareholders is likely to frustrate the objective of fair treatment.

International competitive capital markets: For the reasons discussed elsewhere in this submission, we consider that the all the proposed options would be damaging for the international competitiveness of New Zealand’s capital markets compared to the status quo.

Autonomous decisions: The Panel’s comments on this issue wrongly equate higher thresholds with autonomous decisions. Shareholders are given autonomy to make decisions

about code companies when they can, by a 75% majority, determine whether or not to proceed with the transaction. A regime under which a small minority of shareholders can effectively block a transaction that is favoured by the vast majority of shareholders denies the majority of the power to decide and therefore undermines the objective of autonomous decision making.

F. What option do you prefer and why?

	Yes	No		Yes	No
No Change	X				
Option 1: Anti-avoidance provisions included in Parts XIII and XV (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 XIII Amalgamations					
Option 5. Prohibit Part XIII and XV reconstructions involving Code companies unless permitted by Panel					
Other					

Comment:

G. (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 arrangement 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:

We believe there may be advantages in lowering the compulsory acquisition threshold under the Code, although we believe that this should be subject to detailed study and consultation before any change is made. In response to the specific questions:

- (a) The 90% threshold is sometimes a factor in decisions to pursue transactions under the Companies Act arrangement provisions. Furthermore the 90% threshold is frequently used by parties wishing either to block a potential takeover or greenmail an offeror into raising its price. There have been a number of examples of this over the years. In many cases opportunistic market participants are able to build a stake of sufficient size (which may be well below the 10% mark, given the level of "inactive" shareholder on any register) at a relatively affordable cost to be in a blocking or greenmail position. The veto or greenmail power that gives them outweighs their relative position as a minority shareholder and the relatively small amount they have had to pay to be able to exert that level of influence.
- (b) In some circumstances, yes.
- (c) We do not believe so, but this is the issue on which we believe further study and consultation is required.
- (d) We believe there may be merit in considering reducing the compulsory acquisition threshold to either 80% in all situations (reducing the opportunities for greenmail or blocking stakes), or possibly 75% in respect of offers that are recommended by the target company's board (while retaining a higher threshold for transactions that are not supported by the target company's board). That would then bring the Takeovers Code thresholds into line with those in the Companies Act.

H. 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:

It is not possible, in our view, to make meaningful comparisons of costs between transaction structures because costs vary significantly depending on the nature of the particular transaction. In our experience, the relative costs of the different alternatives is not a material factor in the choice between transaction structures.

Legal, accounting and other advisors' fees (apart from investment bank fees) generally tend to be time based and therefore vary depending on the amount of time involved which is often influenced by many factors other than the transaction structure.

Independent experts' or advisors' report fees do not vary significantly as a result of the transaction structure.

Investment banking or financial advisory fees tend to be based on transaction consideration and are therefore not influenced by transaction structure. Investment banking fees also tend to be significantly higher than other advisers' fees and, because they are generally transaction consideration based, do not feature to any degree in decisions as to which transaction structure is the most appropriate.

The amount of staff, management and board time that must be dedicated to a particular transaction also does not tend to be driven by the transaction structure to any great degree.