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IN THIS ISSUE

- The impact of the High Court and Court of Appeal decisions in respect of the Dominion Income Property Fund Limited scheme of arrangement.

The High Court and the Court of Appeal decisions in November 2006 have significant implications for the promoters of schemes of arrangement involving code companies intended to be effected under Part 15 of the Companies Act 1993.

Dominion Income Property Fund Limited scheme of arrangement

POLICY BACKGROUND

The Takeovers Panel has been concerned for some time about the increasing use of schemes of arrangement under the Companies Act as a means of avoiding the provisions of the Takeovers Code when seeking to change the ownership or control of code companies.

The Panel issued discussion papers (4 April 2006 & 19 June 2006) seeking the market's comment on possible changes to the Companies Act and Takeovers Code where it is intended to change ownership or control of code companies by an amalgamation under Part 13 of the Companies Act or a scheme of arrangement (which can include an amalgamation) under Part 15 of the Companies Act.

The Panel subsequently recommended changes to the law to the Minister of Commerce. The changes would:

- remove schemes and amalgamations from the Code; but
- make the Companies Act processes (where they affect the control of code companies) take account of the principles of the Code and be subject to the comment or approval of the Panel.

These recommendations are currently with the Minister.

In May 2006 the Panel told the market that, pending the review of the law governing schemes and amalgamations, it would take steps to mitigate the use of schemes of arrangement to avoid the protections for shareholders contained in the Code. One of these steps was to seek to be heard by the High Court when proposed schemes of arrangement involving code companies are being considered.

The Panel believed that submissions from the Panel would assist the Court in its supervision of schemes of arrangement. Submissions would address the use of the scheme procedure and the protections contained in the scheme for shareholders, particularly minority shareholders, taking into account the special status of the control of code companies contained in the Takeovers Act 1993 and the Code.

The Panel's actions were limited to schemes of arrangement under Part 15 of the Companies Act because, unlike amalgamations under Part 13, the terms of schemes, and their ultimate coming into force, require High Court approval.

DETAILS OF THE SCHEME OF ARRANGEMENT

In late September 2006 the Panel became aware of an application for the High Court to approve an amalgamation under Part 15 of the Companies Act. The proposed scheme was to amalgamate three property investment companies of the Dominion Group - Dominion Income Property Fund Limited (Dominion Income), Property Fund Thirty-One Limited (PF31) and Dominion Newmarket Limited (Newmarket) - all of which are managed by Dominion Funds Limited (Dominion Funds). PF31 and Newmarket were to be amalgamated with Dominion Income, which was to be the surviving company.

Dominion Income and PF31 were code companies, having assets of more than $20 million and more than 50 shareholders. Newmarket became a code company on 25 October 2006 when the $20 million minimum asset threshold was removed from the definition of code company (through the Takeovers Amendment Act 2006).

Each of the three amalgamating companies had three forms of issued securities: Group A shares, Group B shares and debentures.

Group A shares are ordinary voting shares. These shares can be voted on all company resolutions but holders only have the right to appoint one director, who must be part of the Money Managers Investment Review Panel. (In each case the appointee has been Mr Douglas Lloyd Somers-Edgar.)

Group B shares are all issued to the directors of the manager, that is, Dominion Funds. Holders of Group B shares have the right to appoint the remaining three directors of each company, but do not share in any distributions by the companies. The other directors of each company are Alastair Burkitt Hasell, Ian Crayley Hasell and Paul John Duffy.

Debentures are debt securities "stapled" to the Group A shares and do not carry voting rights.

Each amalgamating company has a widely spread shareholding with no individual shareholder in any company having more than 2% – 3% of the voting rights.

When the Panel became aware of the amalgamation the High Court in Auckland had already made orders under s236 of the Companies Act (applied for by the Dominion Group) which established the basis on which the amalgamation proposal was to be put to the shareholders of each company for their approval.

In essence these initial orders said that the scheme required approval by special resolution (75% of each class of shareholder of each company entitled to vote and voting). Voting was to be by postal ballot. The Court dispensed with the requirement for a meeting of shareholders of each company and with the requirement for a minimum quorum of voters, although quorum in each company's constitution – two voters – was very modest anyway. The Court also ordered that a minority buy-out right should not apply in this case. A minority buy-out under the Companies Act allows shareholders who vote against the proposal to be bought out of their holding for a fair and reasonable cash sum. This requirement is an integral feature of an amalgamation under Part 13 of the Companies Act i.e. where there is no court involvement.

THE PANEL'S FIRST ACTION IN THE HIGH COURT IN AUCKLAND

The Panel was concerned that the initial Court orders could result in the scheme being approved by a small number of shareholders because the 75% majority relates only to shareholders who vote on the proposal. For example, if only 10% of the total voting rights were exercised, the proposal could proceed with the support of only 7.5% of the total voting rights.

No single shareholder would move to a voting position which might have a control consequence in respect of the continuing or surviving company (in the sense that any single holder would have over 20% of the voting rights in the surviving company (Dominion Income)) but the collective group of PF31 shareholders would have only 24.1% of the voting power in Dominion Income, and Newmarket shareholders would have only 6.5% of the voting power.

The Panel decided to ask the High Court to amend its initial orders so that the amalgamation required the approval of 75% of those eligible to vote and voting in each company, and also a simple majority of the total voting rights in each company.

This was in accordance with the broad principles of the Code. A takeover cannot succeed without the offer being accepted by the holders of more than 50% of the voting rights in the target company. A positive vote by holders of a majority of the total voting rights in the company was a reasonable equivalent to the Code's requirement for the positive act of acceptances by the same majority of shareholders where change of legal control occurs by means of a takeover offer under the Code.

There is an argument that an amalgamation is in effect a compulsory acquisition, which, if it were a code transaction, would require the dominant owner to obtain 90% of the total voting rights in the target company. However, the Panel recognised (a) that this amalgamation was a true merger with no single shareholder obtaining control of the amalgamated entity and (b) that shareholders in the two target companies were to receive shares and debentures in Dominion Income. No shareholder would be forced to take cash for their shares and cease to be a shareholder.

In these circumstances the Panel was comfortable that, in addition to the special resolutions, approval by a simple majority of the holders of each company's total voting rights was an appropriate minimum voting threshold.

The Panel applied to be heard in the High Court to have the Court's initial orders amended. Dominion Group opposed

the Panel's application to be heard and opposed the amended orders the Panel was seeking.

The parties obtained an urgent Court fixture because Dominion Group's documentation was about to be posted to shareholders. The matter was heard in the High Court in Auckland on 17 and 18 October 2006 before Stevens J.

HIGH COURT DECISION

Stevens J issued an oral judgment on the afternoon of 18 October 2006. This was followed by his written reasons on 20 October 2006.[1]

The first order made was that the Panel was granted leave to be heard on the application, being a person "interested" in the proposed amalgamation.

His Honour observed [para 53] that the approach of the Courts to questions of standing has tended over the years to follow a liberalising trend. Stevens J noted that the Court would be influenced by the nature of the issues for decision and the type of assistance available from the party seeking to be heard. The characteristics of that party, including its own objects, purposes, functions and expertise, would also be relevant. Each case would be considered on its merits and in the light of all the circumstances of the case. His Honour said:

> *"A reasonable touchstone seems to me to turn on the ability of the party seeking to be heard to provide relevant and meaningful assistance to the Court on the issues for decision. In other words, can it genuinely assist the Court on the matter for decision?"*

Stevens J cited with approval a passage from Professor Joseph's text on Constitutional and Administrative Law in New Zealand (2 ed, 2001) at 1008 which concluded with a quotation from Cooke J:

> *""Any tendency to consider the issue of standing in insolation [sic] from the nature of the complaint is resisted." Standing was to be decided "on the totality of the facts.""*

His Honour said [56]:

> *"In the context of an amalgamation under Part 15 of the Act, where the Court has a supervisory role, I consider that a similarly broad view should be taken to the question of standing. If one looks at the issues which the Court must consider under s236 of the Act, there may well be circumstances where it would be entirely appropriate for the Court to be assisted in how it might exercise the wide discretionary powers which arise with a body with the expertise of the Panel."*

He concluded [59]:

> *"In this case, the Court determining issues under s236 of the Act has a broad supervisory jurisdiction, and must consider a range of discretionary factors. I have been assisted by hearing from the Panel about matters within its area of expertise. I have had an opportunity to consider the additional factual material placed before me and the submissions and arguments of counsel, particularly where, as here, it is limited to a procedural issue. I also consider that, had this information and arguments (from both sides) been available to the Judge [Asher J] who considered the ex parte application and made the initial orders, it would have materially assisted him in the exercise of the Court's supervisory jurisdiction. … Accordingly, I consider that the Panel should be granted leave to address matters of relevance to the principles which apply to an amalgamation under Part 15 of the Act."*

The second order made set aside one of the Court's original orders relating to the quorum of voters required to vote on the amalgamation resolution. A new order was substituted requiring the amalgamation resolutions in each company to be approved by voters representing a majority of the total voting rights in each of the applicant companies. A third order set out arrangements to notify the Panel of the result of the voters' poll.

His Honour addressed several issues in deciding that the Court could make new orders and set aside some of the Court's original orders under s236 of the Act.

The first issue concerned the scope of the Court's powers under Part 15 of the Act. Asher J made the initial orders on 21 September 2006 under s236 of the Act. The principles applied by Asher J in making the initial orders were as set out in Re C M Banks Ltd [1944] NZLR 248 and endorsed by the Court of Appeal in Weatherston v Waltus Property Investment Limited [2001] 2 NZLR 103.

The principles set out in Re C M Banks Ltd are that:

> *"The duty of the Court is to see (1) that there has been compliance with the statutory provisions as to meetings, resolutions, the application to the Court, and the like; (2) that the scheme has been fairly put before the class or classes concerned; and that if a circular or circulars have been sent out, as is usual, whether before or after the making of the application to the Court, they give all the information reasonably necessary to enable the recipients to judge and vote upon the proposals; (3) that the class is fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and*

are not coercing the minority in order to promote interests adverse to those of the class they purport to represent; and (4) that the scheme is such that an intelligent and honest man of business, a member of the class concerned and acting in respect of his interest, might reasonably approve."

The second issue concerned the powers of the Court to vary ex parte interlocutory orders. Stevens J cited r 259 of the High Court Rules. His Honour said that this was a review power which should be exercised first, rather than taking an appeal. The judgment noted that the approach of the Court in such a case was summarised in the case D B Baverstock Ltd v Haycock [1986] NZLR 342 where Henry J said at 344:

"It is common ground that the purpose of an application under r 264 [equivalent of current r 259] to rescind an ex parte order is to establish a hearing de novo in the presence of the defendant … The purpose of that is to enable a Judge to consider whether, on the basis of all the evidence and the arguments advanced, the interlocutory orders should stand. Ex parte orders are provisional by nature, being made on the basis of evidence and submissions from only one side, and for that reason are subject to review without inhibition."

The third issue was whether the Court should amend or vary the initial orders.

Stevens J said there were a number of factors to be taken into account.

The first factor was the dispensation with the shareholder quorum, which His Honour said did not seem to have been considered in any depth (if at all) at the first hearing.

The second factor was the makeup of the shareholding in the Dominion companies. Stevens J noted that the widespread nature of the shareholding meant there was a real possibility that the amalgamation could come into effect through the votes of only a small number of shareholders in each company. His Honour said that his concern was exacerbated by the fact that the proposal was being advanced by the managers, with no significant or focussed shareholder interest monitoring the amalgamation.

A further factor was the change of control of the three amalgamating companies. His Honour said [74]:

"The applicant companies submitted that there would not be a change of control with this amalgamation. However, I consider that, viewed as a matter of substance, there will be a change of control of voting rights in outcome following amalgamation. The shareholders in one of the applicant companies will plainly have diminished rights in respect of particular investments they originally had, as compared with their new (amalgamated) investments. Mr Dobson cited as an example a body of shareholders in one of the applicant companies who may have control now by virtue of a voting pact. Post amalgamation, such control could have disappeared, thus demonstrating the change in voting control which would result from the amalgamation. Accordingly, I consider (as did the Panel) that in a substantive sense the proposal to amalgamate would involve a change of voting control."

His Honour went on to say [75] that he considered a procedure setting a majority of voting shareholders was appropriate in all the circumstances of the case. He added [76] that it would be unsatisfactory to not amend the initial orders but rather wait until the shareholders had voted. Stevens J said he considered that shareholders should receive notice of any additional orders at the same time, or as close as possible, to the distribution of the shareholders' information package.

A further order made by Stevens J required the Dominion Group to notify the Panel forthwith with the results of the votes in each company and whether the Group intended to pursue their application for final orders. The Panel was then given 3 working days of such notification, or by 17 November 2006, whichever was the latest, to file an application for leave to appear and be heard on the application for final orders.

COURT OF APPEAL DECISION

Dominion Group appealed the decision and a Court of Appeal fixture was obtained on an urgent basis for 26 October 2006. The one-day hearing was before William Young P, Chambers and Ellen France JJ on that day.

The Court of Appeal allowed the appeal.[2] The original High Court order providing that there would be no quorum of voters required for the postal ballot was reinstated and the requirement for approval by the holders of the majority of voting rights in each company removed. Minor changes were made to the timetabling orders to accommodate the delay caused by the Court process. The order made by Stevens J requiring that the Panel be notified of the outcome of the shareholder voting was left in place. However, the reference to 17 November 2006 was removed giving the Panel only two working days from receipt of the voting results in which to file an application for leave to appear and be heard in relation to the final orders.

A number of the comments by the Court are relevant.

At paragraph [20], after discussing the three different mechanisms for a change of control of code companies (amalgamation under Part 13 of the Companies Act, scheme of arrangement under Part 15 of that Act, or mechanism under the Code) the Court said:

> *"While the Part 15 process does not provide all the benefits for shareholders that are available under Part 13 and the Takeovers Code, some safeguards are available for dissenters under Part 15 which are not available under the other mechanisms. These are associated with Court supervision and the right of dissenters to have access to the Court."*

The Court addressed the issue of whether the amalgamation was a takeover. The Court noted [24] that the issue was quite complex and not well suited to being addressed in an oral judgment issued under time pressure.

At [25] the Court noted that the Code was not engaged by the amalgamation process, essentially because the amalgamation would not involve the acquisition by any person or group of associated persons of more than 20% of the voting rights of the code companies involved. The Court noted that the shareholdings in each company are widely spread.

The Court observed [26] that:

> *"That the Code is not engaged is not, in itself, a controlling consideration in terms of whether the proposed amalgamation is a "takeover", an expression that is not defined in either the Code or the Takeovers Act.*

Counsel for the Panel, Robert Dobson QC, argued that the amalgamation would produce an outcome that is practically the same as if Dominion Income had taken over PF31 and Newmarket. This view was supported by correspondence the Dominion Group was to send to shareholders which described them "exchanging" old shares in PF31 and Newmarket for new shares in Dominion Income. Counsel also noted that the ability of the shareholders in the two smaller companies to influence events would be watered down. The Court noted:

> *"Mr Dobson's propositions are true, but likewise are not controlling considerations. The fact remains that the amalgamation does not engage the Code and the law generally does not yet equate form and substance."*

Counsel for the Dominion Group, Ralph Simpson, argued that the amalgamation was not a takeover for the purposes of the Takeovers Act. This was because in his view no party obtained effective control of a company. The Court said [29]:

> *"Without finally determining the question, we suspect that Mr Simpson is right but we do not see this as being of critical significance in the context of the case as a whole."*

The absence of a shareholder meeting did not weigh heavily with the Court of Appeal in the context of the appropriate voting threshold.

While the Judges acknowledged that meetings are given considerable significance in the Companies Act, to the point where (s122 of the Companies Act) if a resolution is to be passed by shareholders where no meeting is held, a 75% majority of the total voting rights of the company is required. In this instance the Court noted that it would not be practicable to have both meetings and a postal ballot. The Court also noted that the evidence before the High Court was that postal voting was likely to result in greater shareholder participation.

The Court noted the Panel's argument that the original voting threshold proposed by the High Court (no quorum requirement) meant that the amalgamation could potentially be approved by a very small proportion of the shareholders who are entitled to vote.

On the other hand the amalgamating companies argued that, because of shareholder apathy, it would be difficult (although not necessarily impossible) to obtain support from an absolute majority of those entitled to vote. They cited the outcome of several previous amalgamations involving the Dominion Group.

After discussion of the two viewpoints, the Court said [39]:

> *"… the merits of the positions advanced by both parties are closely balanced. But there are three points which lead us to the view that the approach taken by Stevens J on this aspect of the case was erroneous."*

The first of these aspects was that s 236(2)(b) of the Companies Act talks of approval not by shareholders, but rather by "meetings of shareholders". While at the first High Court hearing Asher J had directed postal voting processes rather than the holding of meetings, the Court said [40]:

> *"But plainly he was acting by analogy with s 236(2)(b)….."*

The second and, in their Honours' words, the more important aspect, was a practical consideration. The Court noted that it was quite possible that the proposed amalgamation would be approved by an overwhelming majority of those who vote (say 95%) but the total votes in

favour may fall slightly short of 50% of total voting rights. The Court noted a number of schemes of arrangement overwhelmingly supported by those shareholders who had voted for them, but where only 42% - 49% of those eligible to vote had voted.

The Judges noted that Stevens J had contemplated the possibility that the scheme might be approved by the Court even if not approved by the shareholders in the manner fixed by the Court. While acknowledging that such an outcome might be possible on a literal reading of s 236, the Justices said [42] that they saw "the scheme of the section as being very much to the contrary."

The third and partly overlapping point was that the Court could see no basis, on the evidence associated with the present case (which appeared "to be a very orthodox amalgamation and not a device to avoid the Takeovers Code") for departing from usual practice, including the usual practice previously adopted for similar amalgamations within the Dominion Group.

Their Honours concluded [44]:

> *"… we see the most appropriate course as being to revert to the orders made by Asher J. If the proposed amalgamation is approved by the shareholders, it will still be for the Court to decide on the final application whether to approve the proposal. The smaller number of votes cast in favour of the amalgamation, the greater must be the scrutiny of the Court. Further, if the Court sees the amalgamation as engaging the policy of the Takeovers Act or an [sic] inappropriate vis-à-vis dissenting shareholders, then this may be relevant to whether the Court, on the application for final orders, should refuse approval or make approval the subject of a buy out of dissenting shareholders."*

The Court next addressed the issue of the standing of the Panel to take part in the proceedings.

The Judges had already determined by this point that the appeal would be allowed on its merits. For this reason [47] they were not inclined to give a final ruling on the standing issue. However the Court said:

> *"We are, however, of the view that it was at least well arguable that the Panel did have standing. Given that Part 13 and Part 15 amalgamations (depending on their structuring) may engage the Takeovers Code and are sometimes used as devices to avoid the Code, we are inclined to think that the proposed amalgamation was legitimately a matter of interest to the Panel under s 8 of the Takeovers Act. On the basis that the Panel therefore had a legitimate interest in the proposed amalgamation, we are inclined to think that it was open to Stevens J to form the view that it was also "interested" for the purposes of s 236(2) and thus to hear it under that subsection."*

The Court noted that the amalgamating companies had argued that the Panel's participation in the hearing was beyond the Panel's powers under the Takeovers Act. At [48] their Honours said:

> *"We prefer to express no definitive view on the Panel's powers although tentatively we think that its participation was within its powers. If the reasoning set out in [47] is right, it might be thought that the Panel's participation in the hearing was sufficiently related to, or "consequential on", its functions under s 8 of the Takeovers Act as being within its powers, given particularly s 14(1)(c) of the Crown Entities Act 2004."*

A further issue addressed by the Court was the ability of the Panel to intervene at the initial order phase of the Companies Act process. This ability had been challenged by the amalgamating companies.

The Court expressed some sympathy for this challenge, particularly given the potential for such intervention to lead to expensive disruptions of procedures put in place by an applicant. The Judges also noted the submission of counsel for the amalgamating companies that there was a real sense in which the applicant must take responsibility for the appropriateness of the initial orders. But they went on [50]:

> *"… the scheme of the section contemplates involvement at the initial order stage by parties other than the applicants. We agree that the initial orders under s 236(2) will almost necessarily be made at the instance of the s 236(1) applicants. But there is nothing in s 236(2) to indicate that the parties who may apply for initial orders are confined to the s 236(1) applicant. For instance, if the 236(1) application is made by a shareholder, it would be odd if the company was not entitled to apply under 236(2) in relation to the initial orders. Further, the fact that s 236(2) permits an initial order to be made also at the instance of "interested parties" (who will not be s 236(1) applicants) implies a power to revise orders."*

Their Honours noted that Stevens J had relied primarily on r 259 of the High Court Rules to justify changing the initial orders. Although acknowledging that this rule may well also have authorised the approach adopted by the Judge, for themselves [51]:

> *"we prefer to approach the case on the basis that s 236(2) itself contemplates further orders."*

The Court commented [52]:

> *"It is important to recognise that the initial orders made by the Court, while not conclusive as to process or substance, are likely to be significant in terms of what happens later. First, shareholders may well assume that the proposal and associated procedure does have the approval of the High Court. Whatever rules are fixed will plainly affect promoter and shareholder alike. Further, compliance with the initially ordered procedure is likely to be a significant factor on the application for final approval especially given the expensive nature of the exercise which will by then have been carried out."*

The Judges concluded [53] that they could see no procedural objection to Stevens J reviewing and supplementing the earlier orders.

VOTING OUTCOME AND FINAL ORDERS BY THE HIGH COURT

The postal voting period ended on 17 November 2006. Later that evening the Panel was advised of the outcome of the votes in each company. The votes in each company were:

	Investor Response	Voting in Favour
Dominion Income	68%	97%
PF31	71%	98%
Newmarket	67%	96%

The Dominion Group's application for the High Court's final approval of the scheme was heard by Asher J on 28 November 2006. His Honour's minute of the hearing included [4]:

> *"A memorandum has been filed on behalf of the Takeovers Panel. The Takeovers Panel has noted that the proposed scheme has been approved by the holders of a significant majority of the total voting rights in each of the companies. As the voting thresholds proposed by the Panel at the earlier hearing have in fact been met, the Panel does not seek to be heard in respect of the final orders for the proposed scheme."*

Asher J's minute concluded by making the orders needed to bring the scheme into effect.

CONCLUSION

The decisions by the High Court and the Court of Appeal on the Dominion Group amalgamation are important signals as to how the Courts are likely to deal with future applications from the Panel to be heard in relation to schemes of arrangement involving code companies.

In particular it appears that:

(1) The Panel will be heard by the Court as a party interested in schemes of arrangement involving code companies;

(2) The Panel's statutory powers include the right to seek to be heard by the Court in relation to a scheme of arrangement involving code companies.

With respect to the merits of the Dominion Income case:

(1) The High Court considered that the merits of the Panel's case supported the Court varying its initial orders to provide for an additional voting requirement of support by the holders of the majority of the total voting rights in each amalgamating company;

(2) The Court of Appeal reversed the decision of the High Court. However their Honours said that this decision was a "finely balanced" one.

FUTURE POLICY

As a result of the Dominion Income case the Panel reaffirms the policy it announced in May 2006 that it would seek to be heard by the High Court on schemes of arrangement involving code companies at the stage that initial orders are being made.

The Panel is willing to engage at an early stage with market participants who plan to promote a scheme of arrangement involving code companies. This will enable any issues the Panel may have with the proposed scheme to be resolved before the initial application under s236 of the Companies Act is made to the High Court.

[1] *Re Dominion Income Property Fund Limited and Ors* (Unreported, 20 October 2006, HC Auckland, CIV-2006-404-5768).

[2] *Dominion Income Property Fund Limited and Ors v Takeovers Panel* (Unreported, 26 October 2006, Court of Appeal CA 229/06).

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