Company reconstructions and arrangements under section 205 of the Companies Act 1955

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Schemes of arrangment between a company and a class of its creditors or shareholders may be sanctioned by the court after a meeting of the relevant class. This article discusses what constitutes a class, disclosure requirements, voting and the principles governing the court's power to sanction. The relationship with takeover law is examined. After advancing several options for reform, the author recommends that takeovers and mergers be excluded from the provisions relating to schemes of arrangement.

I INTRODUCTION

Pursuant to section 205 of the Companies Act 1955, where an arrangement or compromise is proposed between a company and a class of its creditors or members, the court may summons a meeting of the class to consider the proposal. If a majority in number representing three-fourths in value of the class present and voting at the meeting vote in favour of the scheme, applications may be made to the court for sanction. Once sanctioned the arrangement is binding on all members of the class.

In this article the writer looks at the manner in which section 205 has been used by companies and interpreted by the courts. It is submitted that despite a significant volume of litigation under the section in Australia, New Zealand and the United Kingdom, a number of uncertainties remain. The writer then focuses on the use of section 205 in the area of mergers and takeovers. It is submitted the legislation permits some takeovers to be effected in a manner never anticipated when the section was enacted. The section seems ripe for reform. A number of possibilities for reform are presented.

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II SECTION 205: THE COURT'S JURISDICTION AND DISCRETION

A *Determining the Correct Class of Shareholders or Creditors*

The first step to be taken under section 205 is to apply to the court to summons meetings of shareholders or creditors. The only meetings which need to be held are meetings of creditors or members whose rights are affected by the proposed scheme.[1] The application will usually be made by the company itself. If however any creditor or member of the company may apply.[2] At this point the court does not consider what classes of creditors or members should be made parties to the scheme:[3]

> The application ... for an order for meetings is a preliminary step, the applicant taking the risk that the classes fixed by the judge, usually on the applicant's request, are sufficient for the ultimate purpose of the section, the risk being that if in the result ... they reveal inadequacies, the scheme will not be approved.

If there are different groups within a class whose interests are different from the rest of the class, or which are treated differently under the scheme, such groups must be treated as separate classes for the purpose of the scheme. Persons who prima facie appear to be members of a similar class should in fact be further divided into two or more classes where[4]

> by reason of some particular matter so affecting the rights of some [it is] impossible for them to pursue their own interest currently with their participating in the pursuit of the interest of the class of which they appear as members.

The decision as to the division into classes can make the difference between success and failure of a scheme. In *Re Hellenic and General Trust Ltd*[5] shareholders approved a scheme of arrangement whereby shares in the company would be cancelled and a second company Hambros Ltd would be issued with new ordinary fully paid shares. Hambros Ltd was to pay out the holders of the cancelled shares. The arrangement was approved by 86.61% of voters in number holding 84.67% in value of the shares but Templeman J refused to sanction it. He held that the meeting of all the ordinary shareholders was not the appropriate class meeting. 53.01% of the ordinary shares were held by a Hambros subsidiary which had voted in favour of the scheme. In his view those shareholders should have been placed in a separate class.[6]

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1 *Re International Contract Co* (1872) 26 LT 385.

2 Section 205(1).

3 *Nordic Bank plc* v *International Harvester Australian Ltd* [1983] 2 VR 298, 303 per Lush J.

4 *Jax Marine Pty Ltd and Companies Act 1961* [1967] 1 NSWR 147; (1966) 85 WN (NSW) 130, per Street J; and see also *Sovereign Life Insurance Ltd* v *Dodd* [1882] 2 QB 573, 583 per Bowen L J.

5 [1976] 1 WLR 123.

6 Above n 5, 125-127.

The decision in *Re Hellenic* might be criticised on the basis that a fair scheme was defeated.[7] In Templeman J's view the subsidiary shareholders were in the same camp as Hambros and not in the camp of the outside shareholders. However the often cited test of what constitutes a class emphasises similarity of rights.[8] The relevant rights in this case were the rights of all the ordinary shareholders against the company in relation to their shares or debts. Arguably those rights were identical and the Court should have treated them as one class. Templeman J's decision may be viewed as conflicting with previous decisions that members of a class are still to be treated as one class, even though they are in "different camps so far as their interests are concerned".[9]

Notwithstanding Templeman J's view that the failure to hold properly constituted class meetings meant he had no jurisdiction to sanction the scheme, he stated that even if he were wrong, he would not have exercised his discretion to sanction the scheme. His Lordship accepted the argument that the scheme by Hambros was one to purchase outside shareholding. Under the compulsory acquisition provisions the scheme could not have been carried out against the wishes of the objectors nor without the votes of the Hambros subsidiary. In Templeman J's view it was unfair to deprive the objectors of shares which they were entitled to assume were safe from compulsory purchase.[10] In this way Templeman J 's decision can be seen as upholding the rights of minority shareholders.[11] Templeman J recognised the economic realities of the proposed scheme and treated the subsidiary as a creature of the offeror company.

The reasoning in *Re Hellenic* will cause difficulties in determining what constitutes a separate class particularly with respect to the parent-subsidiary relationship. Templeman J was of the opinion that where the "parent controls 50% or more of the shares of the subsidiary company it can be assumed that they have a community of interest ... and in most cases a different interest from that of other shareholders".[12] This view involves the assumption that the directors of the subsidiary will vote in the interests of the parent company. In the context of a wholly-owned subsidiary this is not an unreasonable assumption.

Where a subsidiary is not wholly-owned it is not entirely clear how the interests of minority shareholders in the subsidiary should be dealt with. It would be unfair to treat them as being identified with the parent company. They might best be considered as having a pro rata interest in the shares held in the subsidiary and be treated as forming a separate class.

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7 See J A Hornby "Class Membership in the Company's Scheme of Arrangement" (1976) 39 MLR 207.

8 *Sovereign Life Insurance Ltd* v *Dodd* [1882] 2 QB 573, 582-583 per Bowen J.

9 *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213; and *In the Matter of Chevron (Sydney) Ltd* [1963] VR 249, 255.

10 Above n 5, 131.

11 See D D Prentice "Corporate Arrangements - Protecting Minority Shareholders" (1976) 92 LQR 13.

12 Above n 5, 127.

Later in *Re Jax Marine Pty Ltd and Companies Act 1961*[13] Street J in the Supreme Court of New South Wales refused to divide a class of unsecured creditors into separate classes. In his view it is unsatisfactory to say merely because the particular motive of one group of creditors is known that the group should be divorced from the class to which the nature of their claim entitles them to belong.[14]

Later in *Re Landmark Corporation Limited*[15] an arrangement was proposed between a holding company and its unsecured creditors. At the meeting of unsecured creditors votes in favour of the scheme were cast by creditors to whom the company owed $2,056,984. This amount included $1,526,097 which was owed to seven subsidiary companies. Of the independent or external creditors, only those owed $93,080 supported the scheme whilst those owed $456,847 voted against it. Street J held that the subsidiary companies were correctly included within the class of unsecured creditors.[16] Accordingly the statutory majority had been obtained. He was of the view however that little weight should be given to the votes cast by the subsidiary companies as they gave no indication as to the wishes of the class of unsecured creditors. He stated the court should be slow to differ from so clear a guide as what the external creditors themselves regard as best in the interests of their class. Street J refused to exercise his discretion to sanction the obstensibly fair (albeit speculative) scheme. The large majority of the external creditors were opposed to it and in his view the opposition was not unreasonable.[17]

More recently in this country in *Re Farmers' Co-operative Organisation Society of New Zealand Limited (No 2)*[18] separate class meetings were held of members, client creditors, secured creditors, other unsecured creditors and trade creditors paid interest. Some of the creditors were direct competitors of the company. By discounting altogether the competitors' votes in calculating the majority it was possible to bring the scheme within the ambit of section 205(2). Quilliam J sanctioned the scheme. It is questionable whether some creditors were not in fact deprived of their rights along the way. It is difficult to see how the competitors could have avoided censure except by voting with the majority. This suggests that a separate class meeting of those creditors should have been held. It is true their rights vis-à-vis the company were the same as those of other creditors. However the fact that they were direct competitors would seem to be sufficient, in the words of Street J "to render it impossible for them to pursue their own interests concurrently ...".

The creation of a separate class for competitors in the *Farmer's Co-operative* case would have avoided the confiscation of their voting rights. In any event however they would have been able to defeat the scheme. That is not unreasonable in this case. The

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13 [1967] 1 NSWR 145 - distinguished in *Re Gazette Construction Pty Ltd* (1985) 10 ACLR 140 (Supreme Court of New South Wales).

14 Above n 13, 148-149.

15 [1968] 1 NSWR 759.

16 Above n 15, 766.

17 Above n 15, 767-768.

18 (1988) 4 NZCLC 64, 101.

approach is less acceptable when competitors represent a small percentage only of total creditors. In such a situation it might be possible to pay out the competitors and then make arrangements with the remaining creditors.

It may be that the Court in *Farmer's Co-operative* was motivated to accept the classes as constituted on the basis of the perceived overall fairness of the scheme. This is pure speculation on the writer's part. The judgment gives no details of the scheme. Nor does it mention fairness. This last omission is a little strange in light of the court's function in a section 205 application to ensure that a scheme is fair.[19] While the opposing creditors raised no objections to the fairness of the scheme, it is difficult to see how they could bona fide have objected to it if they regarded it as fair. If the objections were bona fide, the Court should have considered the question of fairness and not been content with the majority vote in the classes concerned. Reasonable objections by major creditors are obviously of relevance in determining the fairness of the scheme.

Clearly setting the classes of shareholders or creditors with an interest in a proposed scheme of arrangement will be a crucial and often difficult task for the scheme's promoters. The recent case of *Re The New Zealand Municipalities Co-operative Insurance Company Limited*[20] highlights the inherent difficulties in this regard. In that case the applicant was a co-operative company incorporated to provide insurance cover for its local authority members. For a number of commercial reasons the company decided to terminate its insurance arrangements, giving its members 12 months' notice of the termination. Alternative arrangements were made for local government insurance with the company taking something of an agency role. The company's board was of the view that it was not desirable to wind up the company. It developed a compromise proposal under which after writing up certain assets the company would capitalise and issue shares to all members on a notional winding up basis which under the company's memorandum of association was to be in proportion to the premiums paid by each member in the preceding five years. An ex parte application for an order calling one class meeting was granted, counsel submitting there was only one class of members affected by the proposed scheme and that accordingly only one meeting of members was required. The meeting was duly held. 94% in number holding 91% in value of the shares voted in favour of the scheme. Some dissatisfied local authorities who had voted against the scheme opposed the sanctioning of the scheme. The opponents were local authorities who were no longer placing insurance with the company. They were happy to accept their entitlement but sought to be paid out rather than be allocated shares.

McGechan J refused to sanction the scheme. In his view the interests of those authorities no longer wishing to support the company were so dissimilar from other authorities as to require separate class meetings. McGechan J noted that, while it might turn out that a sufficient majority at a meeting of members who no longer supported the

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19 *In re Milne and Choyce Ltd* [1953] NZLR 724, 745; and *Re National Dairy Association of New Zealand Limited* unreported, Auckland High Court M No 423/86, 02/12/87, Smellie J, p 16.

20 Unreported, Wellington High Court M No 368/88, 07/02/89, McGechan J.

company would favour the proposal for a notional winding up distribution, that was a matter for such a meeting to determine and not for the Court to second guess.[21]

Regardless of the merits or otherwise of the *NZMCIC* decision, the case highlights the difficulties existing under section 205 and the anomaly of having to seek initial court sanction to call meetings without being certain, until a final application to sanction the scheme is made that suitable divisions into classes have been made. It is submitted that judicial examination of the classes proposed to be called would be better made at the time an order calling the meetings is sought. In this way the risk of expensive and unnecessary meetings could be avoided. The court's role at the time of a second application would be simply to ensure that the class meetings as approved were in fact held and that the necessary majorities had been obtained and procedural requirements complied with.

B Disclosure Requirements

Section 206 requires that a statement explaining the effect of a proposed compromise or arrangment be sent with every notice summoning a meeting pursuant to a scheme under section 205. The notice must state the material interests of the directors of the company and whether such interests arise in the directors' capacity as such or as members, creditors or otherwise. If the effect of the compromise or arrangement is different in regard to the interests of the directors from the effects in regard to the like interests of other persons, this must be stated.[22]

Directors tread a fine line in assessing the adequacy of disclosure. The court has a duty to ensure shareholders and creditors are able to make an informed decision. Against this, directors should not be compelled to reveal, unnecessarily, price sensitive company information which could be to competitors' advantage.

It is now clear that material interests of directors and any effect of the scheme thereon must be disclosed separately.[23] It is insufficient simply to disclose material interests which will be differently affected by the arrangement from like interests of other people. As a general rule the court has no discretion to dispense with the requirement even if it is likely that members or creditors will not suffer any detriment through the failure to comply.[24] In the absence of compliance with the requirements under section 206 a court has no jurisdiction to sanction a scheme. The policy behind the disclosure requirements is clear. Creditors and shareholders must be placed in a position where they may make an informed decision on the merits or otherwise of a proposed scheme.

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21 Above n 20, 17.
22 Section 206(1)(a).
23 *Re Burnham House Publishing (In Receivership)* (1987) 3 NZCLC 99, 974, 99, 978.
24 *Scottish Eastern Investment Trust Ltd* [1966] SLT 285.

Plowman J noted in *Re National Bank Limited*[25] that the extent of disclosure required must depend upon the nature of the scheme. In *Re Stewart & Sullivan Farms Limited*[26] Barker J refused to sanction a proposed scheme on the basis, inter alia, that section 206(1)(a) had not been complied with. In that case the company sent out a statement which did not refer to the material interests of the directors. That failure was held to be a fatal defect. Barker J stated:[27]

> The preliminaries are essential jurisdictional requirements before the scheme can be approved; no matter how desirable the Court may think it is in the interests of the parties, if those preliminaries have not been fulfilled, then the scheme cannot be approved.

More recently in *Re Burnham House Publishing Limited (In Receivership)*[28] Thorp J adopted a more pragmatic approach. In his view section 206(1)(a) imposes three separate requirements:

(a) To explain the scheme fairly;
(b) To disclose material interests; and
(c) To explain the effects of the scheme on those interests.

In a scheme proposed by the shareholders debts owed by the company to them were not disclosed prior to the meeting. Thorp J emphasised the significance of the word "material" in resolving the conflict between the two approaches to the effect of non-compliance with section 206(1)(a). In his view relatively insignificant examples of non-compliance are excusable. Had the disclosed interests in that case been excluded from voting, however, there would not have been the necessary 75 percent majority in value of creditors to approve the scheme. It was impossible in that case therefore to regard the non-disclosure as de minimis in nature and thus excusable.

Thorp J's approach in *Re Burnham* is a helpful one which is reconcilable with *Re Stewart & Sullivan*. As Thorp J noted the language used by Barker J in *Re Stewart & Sullivan* supports strict compliance with section 206(1) rather than a pragmatic approach. However the failure to comply with the scheme provisions requirements in that case was blatant and gross. There was not simply an error or deficiency in disclosure. There was *no* disclosure of the material interests of the directors. The significance of a relatively minor departure from the statutory obligations would not have been in the forefront of Barker J's mind. It is submitted his Honour's findings are not inconsistent with Thorp J's holding in *Re Burnham* that insignificant, that is, non-material, examples of non-compliance are excusable.

Thus it seems that, while the matter will be approached strictly, the duty of disclosure is not an absolute one. Not every relevant fact can be stated or the statement would assume such a length as to defeat its own object. Further and more importantly

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25 [1966] 1 WLR 829.
26 [1981] 1 NZLR 712.
27 Above n 26, 718.
28 Above n 23, 99, 979.

the disclosure requirements are subject to a de minimis rule. Where initial disclosure statements omit certain facts *or* after disclosure has been made new facts arise which are not subsequently disclosed *or* new facts come to light at a meeting, the insufficiency of the initial disclosure will not be fatal if the information is of such a nature that even if it had been disclosed no reasonable creditor or member would have changed his or her position in light of it. Sufficiency of disclosure may only be determined in relation to the materiality of the information concerned in the circumstances of the particular case.

Clearly a cautious approach is required in determining whether information or interests may legitimately be withheld from the statement. The only safe rule is that in doubtful cases it is wiser to disclose than refrain from doing so. Section 206 emphasises the fiduciary duty of a director. In short it compels disclosure within a reasonable time of every type of "interest", legal or equitable, which in a business sense might reasonably be regarded as of relevance to the company creditor or shareholder in deciding whether to vote for or against a proposed scheme.

C Manner in Which Votes May be Validly Exercised at Scheme Meetings

As a general rule voters have no obligations to other voters and may vote as they please.[29] However where a majority is given powers to bind a minority and in so doing to alter the minority's rights, that voting power is fettered. While the majority voter is not a fiduciary as such, the law recognizes a position of responsibility. Where a voter (or a group of voters) is able to exercise control and is in a position to abuse the rights of the minority an obligation arises to exercise the vote in the interests of the class as a whole.[30]

Recently in *Re Farmers' Co-operative Organisation Society of New Zealand Limited*[31] the treatment of votes tainted with personal or special considerations was considered. A number of the company's creditors were in competition with the company. Opposition to the application for an order sanctioning the scheme was made on the grounds that the competitors had cast their votes out of self-interest and not in the interests of the whole class. Quilliam J upheld an argument that those votes should be discounted in calculating the majority. He viewed the case as a straightforward instance of voters acting in self-interest rather than in the interests of the class as a whole.[32]

By excluding the competitors from the calculations the necessary majorities were obtained. The group was not in a position of being able to oppress a minority. Nor was there any issue of mala fides on the part of the competitors. The group simply carried the power to block a resolution and did so. Quilliam J seemed to be saying that

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29 *Pender* v *Lushington* (1877) 6 ChD 70; *Clemens* v *Clemens Bros Ltd* [1976] 2 All ER 268.

30 *British America Nickel Corp Ltd* v *M J O'Brien Ltd* [1927] AC 369, 371; and see also *In re Holder's Investment Trust Ltd* [1971] 1 WLR 583, 586 per Megarry J.

31 Above n 18.

32 Above n 18, 64, 105.

a competitor could never vote in the interests of the class by virtue of its own self-interest as a competitor. It appears the competitors' votes would have been objected to whichever way they had been cast.

It would surely be going too far to suggest that a class member may never vote in self-interest where the rights of others might be affected. This presupposes the existence of some objective test of what is in the best interests of the class. It is submitted that no such test exists and that what is in the best interests of a class depends in turn on the membership of that class.

It is unreasonable to expect competitors to ignore their trade interests. It has been suggested that the competitors should have been placed in their own class. In this way they would have been able to vote in their own interests and not be deprived of their voting rights.[33] Against this however, to break creditors up into clases gives each class an opportunity to veto the scheme. This undermines the basic approach of decision by a large minority. It should be permitted only if there are dissimilar interests related to the company and the scheme which require protection.[34]

The decision in *Re Farmers' Co-operative* to discount the competitors' votes when calculating the majority is contrary to a number of earlier decisions. While in the *Re Hellenic* case the subsidiary shareholders' votes were discounted, the interested party was held to constitute a separate class. In this way it was not entirely deprived of its rights. In *Re Chevron (Sydney) Ltd*[35] Adam J stated:[36]

> In so far as members of a class have in fact voted for a scheme not because it benefits them as members of the class but because it gives them benefits in some other capacity, their votes would of course, in a sense, not reflect the view of the class as such although they are counted for the purposes of determining whether the statutory majority has been obtained at the meeting of the class.

In Adam J's view individual interests of voters are factors to be considered at a later stage when determining what weight should be accorded to various votes. This has been the approach taken in *Re Jax Marine*[37]; *Re Landmark Corporation Ltd and Companies Act*[38]; and *Re International Harvester (Aust) Limited Receivers & Managers appointed & others.*[39] Recently in this country McGechan J in *Re the New Zealand Municipalities Insurance Company Limited* reviewed these authorities and approved them.[40]

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33 See A Beck "Creditors' Right to Vote in s 205 Proceedings" [1988] NZLJ 22, 28.

34 *In re National Harvester (Aust) Ltd and Receivers and Managers appointed and others* (1983) 7 ACLR 796, 799, referred to by Smellie J in *Re National Dairy Association of New Zealand Ltd*, above n 19, 39.

35 [1963] VR 249.

36 Above n 35, 255.

37 Above n 4.

38 Above n 15.

39 Above n 34.

40 Above n 20, 14-15.

It is submitted with respect that Barker J erred in refusing to take the competitors' votes into account in calculating the majority in *Re Farmers' Co-operative*. If he believed the competitors interests were so different from the rest of the creditors' that they should have formed a separate class, it is submitted he should have refused to sanction the scheme on that basis. If he believed all creditors should have formed one class, the votes of the competitors should not have been discarded. If the votes had been included then the 75 percent majority required by statute would not have been obtained. On this basis the Court would not have had jurisdiction to consider the scheme at all.

The position seems to be this. In many instances voters in the same class will have different individual interests and considerations. Presuming the class has been correctly constituted, in that those interests are not so vastly different from the interests of the class as a whole as to make it impossible for members to consult together, those votes should not be discounted in calculating the statutory majorities. It is submitted the position is best summarised by Adam J in *Re Chevron (Sydney) Ltd*:[41]

> ... where the members of a class have different interests because some have and others have not interests in a company other than as members of the class the Court may treat the result of the voting at the meeting of the class as not necessarily representing the views of the class as such, and thus should apply with more reserve in such a case the proposition that the members of the class are better judges of what is to their commercial advantage than the Court can be.

Technically then, not every vote cast at a class meeting is entitled to equal weighting. It is only at the discretionary stage however that such weighting may be used.

D Principles Relied on by the Court in Sanctioning a Scheme

The duties of the court in determining whether a compromise or arrangement should be sanctioned are two-fold. The first is to see that meetings have been duly convened and held and that the resolutions are passed by the statutory majority in accordance with the section. Upon this depends the jurisdiction of the court to confirm the scheme. The second duty is in the nature of a discretionary power. Here the court examines the scheme in the circumstances of the case and asks whether "the scheme is a reasonable one, and whether there is any reasonable objection to it, or such an objection to it that any reasonable [person] might say that he [or she] could not approve of it".[42]

Although the wishes of the creditors or shareholders are an important consideration, the court has an independent discretionary role in approving a scheme. It may take into account not only commercial considerations but questions of public policy.

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41 Above n 35, 255.

42 *Re Alabama, New Orleans, Texas & Pacific Junction Railway Co* [1891] 1 Ch 213, 238-239 per Lindley L J.

In *Re C M Banks Limited* Smith J summarised the principles to be applied by the court when asked to sanction a scheme as follows:[43]

(i) There must be compliance with the statutory provisions as to meetings, resolutions and the application to the Court;

(ii) The scheme must be fairly put before the class(es) concerned. If a circular has been sent out, as is usual, whether before or after the making of the application to the Court, it must give recipients all the information reasonably necessary to enable them to judge and vote upon the proposals;

(iii) The class must be fairly represented by those who attend the meeting. The statutory majority must act bona fide and not coerce the minority in order to promote interests adverse to those of the class whom they purport to represent; and

(iv) The scheme must be one that an intelligent and honest person of business, a member of the class concerned and acting in respect of those interests, might reasonably approve.

Implicit in the fourth requirement is that the scheme is fair and reasonable to all the classes concerned.[44] These requirements have been expressly referred to and applied in a number of cases, most recently by McGechan J in the *NZMCIC* case.

In addition it appears the court will protect creditors and members who have voted against a scheme or have not voted, in three broad situations:[45]

(i) where the scheme is unreasonable;

(ii) where the majority who voted for the scheme did not vote to promote the interests of their own class but to foster some extraneous interest; or

(iii) where the scheme is unfair on its face.

In practice the three grounds may overlap. It may be, for example, that unreasonableness and unfairness are merely facets of the same ground for judicial refusal to sanction and that any scheme which a court is likely to refuse to sanction because it is unreasonable will also fall down on the grounds of unfairness and vice versa.

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43 [1944] NZLR 249, 253; see also *Re Stewart and Sullivan Farms Ltd* above n 26, 717.

44 *In re Milne & Choyce Limited*, above n 19.

45 See R R Pennington *Company Law* (5ed, Butterworths, London, 1985) 594; *Carruth* v *Imperial Chemical Industries Ltd* [1937] AC 707, 769 per Lord Maugham; *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385, 409; *Re Consolidated South Rand Mines Deep Ltd* [1909] 1 Ch 491, discussed by Pennington, 595; for examples of consideration of whether a scheme was unreasonable, see *Re Chevron (Sydney) Ltd* above n 35; *Re Lankmark Corporation Ltd* above n 15; and *Re Direct Acceptance Corporation Ltd* (1987) 5 ACLC 1037.

Despite the view taken by the court of its functions, the court is ill-equipped on the information before it to examine the detailed implications of a scheme submitted for its approval. Rarely can it do more than exercise the judgment of a reasonable person possessed of the limited information which an investor usually has.[46] This means that the court's decision whether to exercise its discretion to sanction a scheme must be based on a broad common sense approach. It will not be based on an in-depth analysis of each detail of the scheme or a comparison of alternative ways the company could have approached the problem the scheme now seeks to solve. Instead the court will look at what the scheme will in fact achieve, paying particular regard to such matters as substantial disproportions between the treatment of different interests.

E Court's Power to Sanction a Scheme Materially Modified by the Meeting

For many years it has not been entirely clear whether the court is able to sanction a scheme which has been modified or amended in any material respect by creditors or members at a meeting. This is notwithstanding that the notice calling the meeting may state that the class shall consider and if thought fit approve a scheme of arrangement "with or without modification".[47]

In *Re Cabinex Holdings Ltd*[48] a scheme was amended at the creditors' meeting by strengthening the powers of the committee of inspection. Holland J concluded that jurisdiction to amend the scheme existed. In his view the provision in section 205(2) is to enable the court to consider the scheme and the fairness of sanctioning the scheme in its ultimate state as approved by the meeting.

In *Re Stewart & Sullivan Farms*[49] the proposed scheme was amended by appointing different managers from those originally suggested; by appointing a fourth manager; and by attempting to remove the powers of the managers to issue additional share capital and to delegate their functions to one manager. Barker J refused to sanction the scheme. In his view the amendments were not simply mechanical. The attitude of creditors might have been different had they known there was a different manager proposed.

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46 Above n 45. It is interesting to note that in the United States schemes which affected the creditors had to be submitted to the Securities and Exchange Commission (a government authority with wide supervisory and regulatory powers over the issue of securities and transactions in them), and the court considered the report of the Commission before sanctioning the scheme (Federal Bankruptcy Act, ss 572-574 (now repealed)). The Commission could also and still can appear as amicus curiae on the hearing of the petition for the court's sanction (Federal Bankruptcy Act, s 608). The value of the Commission's power to intervene is that it will probably possess or have access to detailed information about the company and its history, and is therefore able to detect latent defects in the scheme more readily than the court can do from the information put before it by the company and dissenting members and creditors.

47 This phrase is included in the form of notice referred to in the minute of Holland J in *Re Cabinex Holdings Ltd* unreported, Auckland High Court M 704/80, 20/06/80.

48 Above n 47.

49 [1981] 1 NZLR 712, 720.

Later in *Re Carpet Time Limited*[50] Chilwell J sanctioned significant amendments to a scheme. The substance of amendments included a strengthening of the prohibition on legal steps which might otherwise be taken by creditors to get paid during the moratorium; the strengthening of the powers of the scheme manager; the creation of a management committee; and a requirement that the manager provide quarterly reports to the committee. Counsel for one of the creditors in opposition argued that there existed no jurisdiction for the meetings to amend the scheme.[51] Chilwell J dismissed the argument without discussing the issue and distinguished *Re Stewart & Sullivan Farms* on the grounds that the order calling the meeting and the notice of meeting in the *Carpet Time* case contained the expression "with or without modifications". It has been suggested however that the same expression was in fact contained in the order and notice in *Re Stewart & Sullivan Farms*[52] although the point was not mentioned by Barker J. If that is true, the precedent value of *Re Carpet Time*, so far as this issue is concerned, is questionable. It would appear that the amendments made in *Carpet Time* were as "material" as those presented in the *Stewart & Sullivan* case.

The issue arose more recently in *Re Villa Maria Wines Limited (in Receivership).*[53] In that case the proposed scheme was amended so that all creditors would be able to claim interest under the scheme. Tompkins J expressly approved of the judgment of Holland J in the *Cabinex Holdings* case and held that the meeting of creditors did have power to amend the scheme. In Tompkin J's view, that followed from the wording of section 205(2). He stated that the reference to "any" compromise or arrangement clearly embraces a compromise or arrangement that may differ from that in respect of which the meeting was called.[54] Further, as Holland J pointed out in *Cabinex Holdings*, if all a meeting could do was accept or reject the scheme as submitted, there would be little point in resubmitting the matter to the court. The scheme could have been approved on the initial application to the court subject to subsequent meeting approval.

Tompkins J in the *Villa Maria* case added the following qualification to the power of a meeting to amend the scheme submitted to it:[55]

> ... if modifications or amendments to the scheme were made at the meeting that were not of a machinery or procedural nature and that could prejudice classes of creditors or members who were not fully represented and able to vote at the meeting, the Court probably would decline to sanction the scheme. The whole procedure of notice to creditors and members, the calling of the meeting and the application for the Court's sanction would need to be repeated.

It is submitted that the correct approach is that adopted by Tompkins J in *Re Villa Maria*. The court has a discretion to sanction a scheme which has been amended at a

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50 (1985) 2 NZCLC 99, 276.
51 Above n 50, 99, 278.
52 New Zealand Law Society Seminar *Recent Developments in Insolvency Law and Practice* (July 1987) 69.
53 (1986) 3 NZCLC 99, 869.
54 Above n 53, 99, 874.
55 Above n 53, 99, 878.

meeting. The test to be applied by the court in exercising that discretion is whether the amendment is material in nature such that it would prejudice voters who had chosen not to attend the meeting. The court is unlikely to sanction an amended scheme if the amendments are so numerous and radical that the court would virtually have to recast the scheme.

III SECTION 205: MERGERS AND TAKEOVERS

Sections 205-207 of the Companies Act 1955 contain a comprehensive statutory takeover and merger procedure. If used, it replaces entirely the usual contractual mechanisms for achieving such reconstructions.

The section 205 procedure does have certain disadvantages. It may take some time to carry out since two applications to the court are required and the scheme is less easily amended than a "true" takeover bid. The target company will be more susceptible to a rival offer since the scheme does not take effect until the court order sanctioning the scheme is filed with the Registrar of Companies. Moreover, since the consent of the scheme company is required the procedure is inappropriate in contested takeovers.

The procedure has a number of significant advantages however. Under section 205 a three-fourths majority of those voting at the class meeting(s) will be sufficient to effect a 100 per cent acquisition of the offeree company. In addition, the disclosure provisions of the Companies Amendment Act 1963 need not be followed when using the section 205 procedure to effect a takeover or merger. Under the usual takeover provisions a 90 per cent majority of outstanding shareholdings acquired within four months of an offer is necessary before the provisions of section 208 can be invoked to acquire compulsorily the remaining 10 per cent. That section may be invoked, if at all, within the following two month period.

The situation in this country and the United Kingdom differs from that in Australia. Prior to the 1981 Australian Companies legislation a takeover by one company of another in circumstances where the management of the target company was not opposed to the bidder could be carried through by means of scheme of arrangement as an alternative to the making of offers to individual shareholders. The case of *Re The Bank of Adelaide*[56] provides a good example of this. Since that case the Australian legislature has controlled resort to the equivalent section 205 procedure where the takeover would involve an acquisition of shares regulated by the Companies (Acquisition of Shares) Act 1980 (Cth) or a State Companies (Acquisition of Shares) Code.[57] That legislation is thought to provide better protection for shareholders in a target company. The control

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56 (1979) 2 ACLR 393. In that case a virtual takeover by the Australian and New Zealand Banking Group Ltd of the Bank of Adelaide was approved as a scheme of arrangement and not a takeover within the meaning of the Acquisition of Shares (SA) Code.

57 This code commenced operation on 1 July 1981. It has effect subject to and in accordance with the Companies (Acquisition of Shares) (Application of Laws) Act, 1981, effective from the same date.

in the Companies Act 1981[58] exists in a direction to the court that it is not to approve a compromise or arrangement unless it is satisfied that it has not been proposed for the purpose of avoiding the Acquisition of Shares Act provisions, or the National Companies and Securities Commission does not object to the compromise or arrangement.

The remainder of this article examines the manner in which the scheme provisions in the Companies Act 1955 may be used to effect what in essence amounts to a takeover under the Companies Amendment Act 1963. The writer seeks to demonstrate the inadequacies of the former in affording shareholders of a scheme company the same measure of protection they would have under the takeover provisions.

A A Takeover Via the Scheme Provisions

A scheme of arrangement may be used as an alternative to a "share-for-share" takeover offer. Shares in the target company not already held by the offeror company would be cancelled.[59] Securities in the offeror company would then be issued to the shareholders of the target company in consideration for the shares cancelled. Finally the reserve in the target created by the cancellation would be capitalised and used to issue fully paid up shares in the target to the offeror. Thus the offeror company obtains all the outstanding share capital of the target. The former shareholders in the target become shareholders in the offeror company and the target becomes a wholly-owned subsidiary of the offeror. The final result is identical with that under a successful share-for-share takeover bid by the offeror for all outstanding capital of the scheme company, completed by compulsory acquisition.[60] This was the case in *Re The New Zealand Farmers' Co-operative Association of Canterbury Limited*[61] where Cook J sanctioned a scheme of arrangement whereby a majority shareholder would acquire approximately 4% of the company's share capital held by a large number of shareholders; some unable to be traced and others who had rejected an earlier takeover offer.

The same result could be achieved by merging the interests of the offeror and target companies in a new holding company controlled by the shareholders of the offeror company. Alternatively the court may exercise its power to make a vesting order in terms of section 207 transferring the undertaking of the target company to the offeror company.

It is submitted the definition of "arrangement" in section 205(5)[62] is not exhaustive nor is there anything inherent in the term itself which prevents the section being used to

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58 Section 315(21).

59 This would involve a reduction in capital. Accordingly the relevant provisions of the Companies Act would have to be complied with.

60 Under the provisions of s 208 of the Act.

61 Unreported, Christchurch High Court, M No 530/82, 2 /12/82.

62 "Arrangement" includes a reorganisation of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both these methods.

effect an arrangement the result of which is the same as a takeover offer under the Companies Amendment Act 1963. It might be argued that the scheme provisions should not be used where mandatory provisions exist in the Companies Act laying down the procedures to be adopted to achieve what the parties are attempting to achieve by way of a scheme of arrangement. It has been held that where a scheme involves fundamentally similar considerations to those pertaining to a different section of the Act yet the reconstruction is outside the scope of that section, the scheme provisions may be used.[63] Thus it might be argued that only where the reconstruction falls strictly within the ambit of another section the scheme provisions cannot correctly be used.

Professor Gower argues that "in view of the wide meaning placed on the word 'arrangement' in section [205], it is difficult to understand why a scheme should cease to be an arrangement merely because it is one which could be carried out under [another section]. It is therefore submitted that ... the Court always has a discretion ..." in such cases whether or not to sanction the scheme.[64] Surely, the argument is not that this type of scheme ceases to be an "arrangement"; rather the scheme provisions should not be used to avoid the statutory requirements of other sections. "The scheme cannot authorise something contrary to the general law".[65]

In *Re National Bank Limited*[66] it was argued that the English equivalent of our section 208[67] ought to have been applied to a scheme. Plowman J stated the legislature had not seen fit to impose any limitation on the generality of the word "arrangement" or on the discretion of the court under the section and he saw no reason for implying one. Further, it was held that the provisions relating to schemes of arrangement involve quite different considerations from a section permitting compulsory acquisition of minority shareholders in a takeover. Under section 205 an arrangement can only be sanctioned if the question of its fairness has been submitted to the court. Under section 208 on the other hand, the matter may never reach the courtroom. If it does, the onus rests on the dissenting minority to demonstrate the unfairness of the scheme. Plowman J stated "there are, therefore, good reasons for requiring a smaller majority in favour of a scheme under section [205] than the majority which is required under section [208] if a minority is to be expropriated".[68]

Arguably however, in sanctioning a scheme under section 205 the court does not really come to grips with the issue of substantive fairness. On that basis it is submitted that the objectors in *Re National Bank* had a strong case. If compulsory

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63 Astbury J in *Re Anglo-Continental Supply Co Ltd* [1922] 2 Ch 723 held that the reconstruction of an existing company by winding up and sale of its entire undertaking and assets for shares in a new foreign company, though quite outside the scope of a reconstruction under s 192 of the Companies (Consolidation) Act 1908, might be effected as a scheme of arrangement.

64 *Gower's Principles of Modern Company Law* (4ed, Stevens and Sons, London, 1979) 692.

65 Above n 64, 687.

66 [1966] 1 WLR 819, 829.

67 Section 209 Companies Act 1948 (UK), now s 428 of the Companies Act 1985 (UK).

68 Above n 66, 830; approved by Legoe J in *Re The Bank of Adelaide* above n 56, 448.

purchase of shares in pursuance of a takeover is felt to be appropriate under section 208 only where 90 per cent of the shareholders have approved the terms of the proposed takeover, it is difficult to see why any less percentage should suffice by using section 205.[69] The problem is even more acute where the offeror company has obtained control through a bid not conferring 90 per cent control upon it or is outside the time limits imposed by section 208 and is then attempting to use section 205 to expropriate the minority.

The fact that an arrangement under section 205 produces a result which is the same as a takeover under section 208 is not necessarily fatal to the sanctioning of the scheme.[70] However it is submitted that the court will not and should not permit section 205 to be used to acquire compulsorily minority holdings where that would be impossible under section 208 by virtue of the size of the opponents' holdings or where the time limits imposed by the section have passed.

It may be that the court would permit section 205 to be used to acquire compulsorily small minority holdings to complete a takeover where the only outstanding shares were held by members unable to be traced. Provided all reasonable attempts have been made to locate those shareholders and provision is made for the holding of shareholders' proceeds in a trust account, the court may well approve the scheme on the grounds of commercial convenience. Outside such exceptional cases it is submitted expropriation of minority interests by way of scheme of arrangement are unlikely to receive sanction.

In the *Re Hellenic* case a note of caution was added to Plowman J's views in *Re National Bank Ltd.* Templeman J noted:[71]

> ... where one has what is in effect a section [208] scheme ... then, putting it at its lowest, there must be a very high standard of proof on the part of the petitioner to justify obtaining by section [205] ... what could be obtained by section [208], especially where there is the added element that section [205] itself only works with the help of a wholly owned subsidiary of the petitioners.

There may well be some scope therefore to argue that the scheme provisions cannot be used where takeover provisions apply. However unless a court is satisfied that a scheme of arrangement is nothing more than a takeover wrapped in section 205 clothing, it may be difficult to persuade the court to withhold approval. The problem will be compounded if the courts adopt a highly formalistic and technical approach in determining what constitutes a "takeover offer".[72]

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69 This is the view taken by Davies *The Regulation of Takeovers and Mergers* (Sweet and Maxwell, London, 1976) 31, fn 4.

70 *In re Hellenic & General Trust Ltd* [1976] 1 WLR 123, 127.

71 Above n 70, 127-128.

72 In *Cumming Smith & Co Ltd* v *Westtralian Farmers Co-op Ltd* (1977) CCC Company Law Cases 29, 901, (Supreme Court of Victoria), Kaye J was firmly of the view that even if the offeror company had succeeded in gaining control of the target company through the implementation of a scheme of arrangement, no relief would be available under the takeover code unless it amounted to a takeover scheme as defined.

Even if the courts in this country adopt the approach taken in *Re National Bank Limited*, that the takeover and scheme arrangement procedures are at times distinct and involve different considerations, it might still be argued the courts are not precluded from insisting that certain provisions of the Companies Amendment Act 1963 be complied with before sanctioning a scheme. Reform in the area of takeover law has in part been motivated by the aim of ensuring that shareholders of a target company are in a position to form a value judgment as to the merits of a takeover. Notions of equal treatment of shareholders irrespective of size of holdings, disclosure of material information and sufficiency of time in which shareholders may consider the offer are reflected in the provisions of the Companies Amendment Act 1963. As the legislature has seen fit to enact provisions to apply in the case of a takeover scheme, it is submitted the courts should be alert to attempts to circumvent those provisions by resorting to the scheme provisions.

B The Protection Afforded to Target Shareholders by Disclosure and Procedural Provisions

It is fundamental to the exercise of judicial discretion in sanctioning a scheme that the court be satisfied all reasonable information was before shareholders to enable them to arrive at a real conclusion. The section 206 notice and the extent of disclosure required thereunder have been discussed above. The scheme provisions envisage a legal relationship between the scheme company and its creditors and members only. By contrast, the 1963 Amendment Act contemplates transactions between two companies and their shareholders. It requires full disclosure in respect of both companies of a wide range of information.[73]

To some extent the shortcomings of the section 206 disclosure provisions (in relation to schemes which are in substance takeovers) are met, in the case of listed companies, by the takeover provisions in the New Zealand Stock Exchange Listing Requirements.[74] Where the Exchange believes a breach of the takeover code in those Requirements has occurred it may suspend quotations of the offeror or the offeree company. If however the courts interpret the phrase "takeover offer" in the Listing Requirements in the same technical sense as they may do with regards to the 1963 Amendment Act it may be that takeovers or mergers adopting the procedural machinery of the scheme provisions will be considered to fall outside the ambit of the Stock Exchange takeover provisions.

No assistance for shareholders can be found in the disclosure requirements under the Securities Act 1979. Where any offer of equity securities is made pursuant to any compromise or arrangement which involves the amalgamation of any 2 or more companies, the offeror company is exempted from compliance with, inter alia, section

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73 See ss 4-5 Companies Amendment Act 1963, and the First and Second Schedules of that Act.

74 New Zealand Stock Exchange Listing Requirements, 1 August 1989, Section 9.

33(1) of the Act, provided its securities are listed on the Exchange and are offered as consideration for the acquisition of securities of another company which are also listed.[75]

The court's approach to the question of its jurisdiction to sanction a scheme is a further means by which shortcomings in disclosure in this area may be met. By strictly enforcing section 206 and the requirement that shareholders be in possession of sufficient information for them to make a real determination, it may be possible to provide shareholders with the information they would otherwise have received had the takeover been effected under the 1963 Amendment Act.

An important consideration for the protection of shareholders is the time available for shareholders to consider the merits of the takeover scheme under the takeover provisions. The 1963 Amendment Act provides the takeover scheme must remain open for not less than one month.[76] By contrast the scheme provisions make no provision for a minimum period of notice to be given to shareholders or creditors of the meeting convened by the court. This is left entirely to the court's discretion. Further, as already discussed, the majorities required for an offeror company to successfully acquire the entire share capital of the target company in a takeover or merger under sections 205-207 are lower than under the takeover provisions.

This difference becomes even more significant when the procedural realities of the meetings are taken into account. It is difficult for an offeror to obtain a 90 per cent interest in the target company where there are a number of disinterested or apathetic shareholders. Ironically, apathy in the ranks of the target shareholders will work to the advantage of the offeror if the machinery of sections 205-207 is used to effect the takeover. Since the percentages and majorities under section 205 are calculated in relation to those "present and voting" at the meeting it is possible for the board of the target company (the scheme company) to obtain the requisite majority and bind all shareholders with a relatively low level of support from the general body of shareholders.[77] Silence under the takeover provisions amounts to rejection of an offer. In a takeover under the scheme provisions silence amounts to acquiescence.

C *Class Considerations In Takeovers*

A number of issues in relation to classes of shareholders entitled to vote at the statutory meeting have already been discussed. In the context of takeovers effected by

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75 The Securities Act (Compromises and Arrangements) Exemption Notice 1987 (SR 1987/286).

76 Paragraph 1, Part A, First Schedule of Companies Amendment Act 1963.

77 See for example *In re the Matters of Chevron (Sydney) Ltd* [1963] VR 249 where the holders of approximately 55 per cent of the shares in the scheme company and approximately 60 per cent of the total value of debenture stock voted in favour of the scheme. The scheme was sanctioned despite the absence of £1m in value of debenture stockholders at the meeting. See also *Re Australian Foundation Investment Co Ltd* [1974] VR 333 where, although the majorities obtained at the meetings were between 80 and 99 per cent, the overall majorities did not exceed 50 per cent of the total issued share capital of each company.

way of scheme of arrangement it is submitted that the court's emphasis on this procedural consideration plays an important role in affording protection to target shareholders.

The basic principles upon which an apparent class should be divided into smaller classes are clear, at least in theory if not in practice.[78] In a takeover under the scheme provisions it may be vital for the approval of the scheme to include the interests of the offeror company and its associates in the scheme company as part of a single class of shares together with external interests. Weinberg, in his work on takeovers, argues that the outside shareholders should be regarded for the purposes of the scheme provisions as a separate class of members necessitating a separate meeting.[79] In the takeover situation, the interests of the offeror company and its associates in the scheme company will be those of purchasers. External interests in the company will be interested as vendors. Since there must be a community of interest of the class it is submitted that the approach suggested by Weinberg is the correct one. The English Court of Appeal in the *Re Hellenic* case appears to have endorsed this view.

Even where the requisite majorities are obtained at class meetings, the court retains the discretion as to whether or not to sanction the scheme. It is submitted that the courts must be aware of the commercial realities underlying schemes of arrangement and be prepared to take these into account in deciding whether or not to sanction a scheme. The courts ought to follow the approach taken in *Re Hellenic* and stand in the way of an attempt by an offeror company through its shareholders in the scheme company to bulldozer a takeover through.[80] This is especially so in light of the frequently low attendance and representation at such meetings.

D Summary

It is submitted that the jurisdictional requirements in the scheme provisions are of limited assistance to the dissenting shareholder in the face of a scheme takeover. This shortfall is highlighted by the protection (albeit limited[81]) afforded by the takeover provisions in the 1963 Amendment Act. For this reason, it is submitted that the exercise of the court's overriding discretion to sanction the scheme is a vital one. In many cases it will be the only hope a dissenting shareholder has to prevent a takeover from being carried out.

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78 Refer Street J in *Re Jax Marine Pty Ltd* above n 15.

79 M A Weinburg, M V Blank & A L Greystoke *Weinburg and Blank on Take-overs and Mergers* (4ed, Sweet and Maxwell, London, 1979) 89.

80 Templeman J refused to exercise discretion in circumstances where it appeared that a [s 205] scheme was being used because the offer would not have succeeded under [s 208] as there was a single holder of over 10 per cent who was opposed to the offer.

81 It is submitted however that the protection afforded by the 1963 Amendment Act is limited in a number of significant respects. While an in-depth discussion of the shortfalls of those provisions is outside the scope of this paper it should be noted that those provisions do not apply where offers are made to six or less members of a target (s 3(6)) and the definition of "takeover offer" is limited to offers made in writing (s 2(1)).

The court's role in sanctioning a scheme of arrangement has been discussed earlier. It has been noted that that role covers matters of both procedure and substance. It seems however that once procedural requirements have been met courts have been reluctant to differ from the view of a statutory majority. Provided members or creditors are acting honestly courts see those parties as better judges of what is to their commercial advantage. Unfortunately there is no provision in New Zealand for judges to appoint an investigator to look into the background to the scheme and its likely success. Scheme promoters are left to present such information as requested.

It is submitted that the decision to respond to a takeover offer and dispose of one's shares should be a decision of each individual shareholder. The takeover provisions enshrine the right of the shareholder to make an informed decision. By contrast, the scheme appears to permit in some instances the expropriation of dissenting shareholders by a technical majority brandishing a court order. It is submitted there is a strong case for legislative amendment of sections 205-207 to afford more protection to target company shareholders.

IV OPTIONS FOR REFORM

Section 205 is currently able to be used to effect transactions which provide limited protection for target shareholders and for which a procedure is provided elsewhere. It is submitted amendment of the section could take one of two forms. It would be possible to exclude mergers and takeovers from the operation of the section. Alternatively, takeover provisions could be incorporated by reference into the scheme provisions.

The first alternative would in effect impose a limitation on the court's discretion to sanction a scheme of arrangement which in substance amounted to a takeover or merger. This might be achieved by excluding from the definition of "arrangement" in section 205(5) any scheme the likely result of which is the same as a takeover effected under the takeover provisions. Alternatively this country could follow Australia's lead and remove the court's jurisdiction to sanction a scheme unless it is satisfied that it has not been proposed for the purpose of avoiding existing takeover provisions, or the Securities Commission does not object to the proposal.

The second alternative would be to incorporate the takeover provisions into the scheme provisions by way of reference. This could be achieved by requiring the court in the exercise of its discretion under section 205 to have regard to takeover provision requirements where applicable. The court could be given the express power to require offeror companies in these situations to comply with disclosure requirements as if a takeover were being effected under the 1963 Amendment Act. The court will then be in a position to entertain a wide variety of objections to a scheme. A high degree of flexibility and skill in applying takeover provisions to schemes of arrangement would be required.

It is submitted that the first alternative of excluding takeovers and mergers from the operation of the scheme provisions is the preferred option. This would provide statutory recognition of the principle that the scheme provisions should not be used to avoid the pre-emptive requirements of other sections in the Companies Act. It would

also ensure that the acquisition of minority interests would only be permitted where 90 per cent of outstanding shares had been acquired. Moreover it will mean one group of provisions exist for takeovers and another for schemes of arrangements. The courts will be forced to assess the commercial realities of a proposed scheme of arrangement and pay more attention to the offeror company. Where a scheme is in effect a merger or takeover the court will be bound to treat it as such.

It is submitted that any amendment to section 205 should be accompanied by a tightening up of the 1963 takeover provisions in the Companies Act. The aim of that Amendment Act was to ensure that shareholders of an offeree company are given sufficient information upon which to exercise their decision to sell and sufficient time within which to reach that decision. In fact a number of significant shortcomings exist in the Act.

The Law Commission's Report on Company Law published in June 1989[82] has among its many proposals advocated company reconstruction following a special shareholders' vote, with dissentient right safeguards where class rights are affected or the reconstruction involves a "major transaction". Where creditors are affected, their approval will have to be obtained. The Commission suggests the involvement of the courts should be modified to a review role.

In order to achieve amalgamation, the board of each amalgamating company will have to resolve that the amalgamation is in the best interests of the company and that solvency tests (as outlined) will be satisfied before and after implementation of the proposal. Directors will be subject to the onerous obligations set out in the Act in making that resolution. The present provisions of the Act requiring court supervision would be retained as a backstop only, where it is not practicable to effect a reconstruction or amalgamation in accordance with the procedures set out in the (new) Act.

At least on their face, the proposals are a step forward in simplifying the procedures for company amalgamations and reconstructions. They will need to be read in conjunction with new draft takeover legislation before an accurate picture of the position of minority shareholders can be obtained.

It is submitted the need for reform is clear. An amendment to section 205 preventing its use to effect takeover at the whim of majorities is required. This will protect minority shareholders from the expropriation of their shares outside the usual takeover avenues.

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82 "Company Law Reform and Restatement" NZLC, R9.