SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE

Takeovers Bill

FEBRUARY 1992

TAKEOVERS BILL

1.0 Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable, an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies which reflect overall New Zealand interests. CS First Boston NZ Limited and Fay Richwhite and Company Limited are also associated with this submission.

1.2 The Bill is designed to provide a legal framework for the operation of the proposed Takeover Panel, including the formation of a takeover 'code'. In addition, the Bill offers some generalised guidelines to the Panel in its tasks, and provides for enforcement of compliance with any code devised by the Panel and approved (presumably on the advice of the Department of Justice) by the minister of justice.

2.0 The Debate - Regulation and Sequence

2.1 The Committee will be well aware that successive governments have received two strong and conflicting streams of advice on the topic of takeover regulation since at least the 1983 discussion documents prepared by the Securities Commission. The most obvious difference between the views of the Securities Commission and contrary views is on the appropriate level of regulation - that is, the imposition of explicit requirements with legal backing and applying to companies irrespective of their internally adopted rules. The contrary view does not challenge whether or not regulation is appropriate but rather the method of regulation i.e. primary reliance on compulsory legislation and general law versus specific takeovers regulation. It also holds that companies should be free to incorporate takeover rules in their constitutions.

2.2 A related division of opinion on the sequence of reform of corporate and commercial law reform in New Zealand has also become apparent. In broad terms, proponents of a regulatory regime for takeovers seek explicit takeover legislation at the earliest possible date, notwithstanding the ultimate shape or impact of the enactment of the Companies Bill also presently before the Justice and Law Reform Committee. The contrary view, which this submission supports, is that a logical sequence of reform involves (i) enactment of a high quality Companies Bill embodying the best modern thought and practice; (ii) observation and analysis of the actual impact of the new Companies Act over a reasonable period of time; and, if shown to be justified in the light of experience with the new Companies Act, (iii) formulation of rules specific to the takeovers situation.

3.0 Submission to Advisory Committee

3.1 The Committee will know that the Takeover Panel Advisory Committee (expected to be reconstituted as the Takeover Panel proper if the Bill is enacted) has called for submissions. The parties to this submission have responded to

the Advisory Committee's invitation and, to avoid repetition, a copy of our preliminary comments to the Advisory Committee is attached and should be read as part of the present submission.

3.2 It will be seen that our central submission is that those responsible for the making of laws must exercise a careful and informed judgment both on what needs to be achieved in the takeover field and on what can be achieved in specific time periods.

3.3 We are particularly concerned that lawmakers do not succumb to the flawed argument that 'something' must be done for the sake of being seen to do something. This is a recipe for bad legislation which, in the takeovers context, will have very real economic disadvantages for New Zealand.

3.4 A further concern is that public comments surrounding the introduction of the Bill - and the very terminology 'Panel' and 'code' - have created expectations that the Bill will in due course lead to a regime similar to that presently operating in the City of London. But the New Zealand market is not the City of London market, and the rules developed in London are by no means immune from powerful criticisms. However, as the Bill is drafted in the most general terms, we have not burdened this submission with a detailed critique of the City of London regime. We expect that, in due course, the work of the Advisory Committee will include a careful analysis of that and other regimes and their relevance to New Zealand.

4.0 The 1988 Securities Commission Report

4.1 We apprehend that the impetus to 'do something' in the takeovers field owes much to the Securities Commission's 1988 report *Company Takeovers*. This appears to have been taken by some as establishing conclusively that 'something must be done', even if debate remains about the details of the recommendations set out in that report. It is our contention that the report does not establish that 'something must be done' and this is elaborated below.

4.2 Althought the 1988 report is lengthy and detailed, and its readability is enhanced by the recognisable style of the Commission's then Chairman, the late Mr Colin Patterson, the report should not be taken as authoritative. It is merely a sustained presentation of one of the competing streams of policy advice. It is noteworthy that the report adopts a different basis for takeover regulation than that advanced by the Securities Commission in 1983, presumably in response to the cogent criticisms which were made of its earlier thinking. However, the recommendations of the 1988 report fail to meet the earlier criticisms.

4.3 In essence the 1988 report is based on the following propositions:

- the notion of equality of treatment of shareholders (the 'pari passu' principle) is of fundamental commercial and legal significance;

- changes in corporate control have in the past involved 'distributive shifts' (i.e. transfers of some of the wealth of the company from one group of shareholders to another); and

- the 'distributive shift' problem should be overcome by explicit rules, based on the 'pari passu' principle, laid down in a statute directed to takeovers in companies whose shares are publicly traded.

4.4 Implicit in those propositions was the Securities Commission's rejection of the various arguments - including those advanced in papers presented in the course of separate visits to New Zealand by Professor Greg Jarrell, Chief Economist of the US Securities and Exchange Commission, and Professor John Pound of the Kennedy School of Government, Harvard University - that the relatively unregulated takeovers market in New Zealand did not require specific regulation, and that the problem areas identified were capable of being addressed through changes in core company law.

4.5 The 'pari passu' principle is not (and never has been) entrenched in our company law; indeed, such entrenchment was not suggested by the Securities Commission. The general concept of equality is simple and attractive, and has many applications in commercial law, but it is not capable of universal application nor is it an objective which should be pursued to the exclusion of other economic considerations.

4.6 Interestingly enough, the 1988 report explicitly recognises that precise equality cannot be expected in relation to the shares of a publicly listed company. The report accepts that the market places a value on parcels of shares and those values may alter depending on the size of such parcels. In particular, the transactions and holding costs associated with a very large parcel of shares may increase the per share value of that parcel compared with a much smaller parcel. Similarly, the voting power associated with shares can quite legitimately increase the value of a majority or influential holding as against an insignificant minority.

4.7 The Securities Commission's use of the term 'distributive shift' was, in the Commission's own words, meant to describe "a transfer of wealth from one set of persons entitled to it to another set who are not". In the United States, the more common term is 'looting' and we suspect that term may be more helpful in the New Zealand debate. The essence of the 'looting' problem is that those who control a company necessarily exercise a wide range of powers in relation to that company, and there is a risk that those powers will be abused in the interests of the controlling parties. The classic examples, found at regular intervals in the law reports, include sales of company assets at an undervalue to a party related to the controller, or purchase of assets at an overvalue. In extreme cases, there is scope for simple theft.

5.0 The Companies Bill

5.1 The answers to the looting problem are, we submit, to be found in core company law with a wide definition of the duties imposed on directors providing the primary legal restraint against looting. At present, the enforcement of such directors' duties is impaired by their relative inaccessability, and the real difficulties and costs involved in enforcement through litigation. These matters will be familiar to the Committee from its

consideration of the Companies Bill, and submissions by the Business Roundtable on the Bill and the ancilliary legislation have covered these issues.

5.2 The relevance of the Companies Bill reforms in the takeovers context is that the directors' duties reforms are likely to address the looting issue for **all** companies, and erode the rationale for specific action which underpins the Securities Commission's 1988 report.

5.3 Put another way, the Securities Commission's analysis of the problems which might justify specific takeover regulation did not take into account sufficiently the likelihood of core company law reform (the 1988 report predating the Law Commission's reports and the Companies Bill). The Commission did recognise that companies and securities regulation involve different considerations, but inexplicably failed to deal with the question of sequence. Nevertheless, there is nothing in the 1988 report which detracts from the logic of Parliament first dealing with reforms to core company law, and then considering matters where further regulation may be justified for specific purposes relating to the securities market.

6.0 Conclusion

6.1 In summary, our submission is that the Committee should report to Parliament that the Takeovers Bill lie before the Committee pending the enactment of, and experience with, the corporate law reform package. At the same time, the work of the Advisory Committee should continue on a more extended timetable and be available to inform later Parliamentary consideration of the proper shape of any legislation dealing expressly with takeovers.

6.2 To avoid any misunderstanding, we should stress that we are not necessarily opposed to any specific legislation regulating takeovers. For example, there may be sound and efficient reasons for specific rules relating to the 'mopping up' of small minorities, although these might also be incorporated into general company legislation. Our submission is that the proper rationale for (and the content of) such rules has not yet been identified. The Advisory Committee, and subsequently the government and Parliament, must analyse and compare the benefits of improved enforcement under the new companies legislation and general law vis-a-vis the net benefits or costs of specific regulation of takeovers before going down a path which could be very costly to business and the economy.