6 December 2023

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cc: Rebecca Budd
Law Clerk
New Zealand Takeovers Panel

RE: Consultations on Regulatory Alignment of Schemes and Code Offers and Deal Protection Devices in relation to Code transactions and Schemes

Dear Mark,

The New Zealand Corporate Governance Forum (**NZCGF** or the **Forum**) appreciates the opportunity to consult with the New Zealand Takeovers Panel (**NZTP** or the **Takeovers Panel**) on the potential for regulatory alignment of Schemes and Code offers, and deal protection devices.

The Forum is committed to promoting good corporate governance of New Zealand companies for the long-term health of the capital market. We believe that good governance improves company performance and increases shareholder value, which is a core focus for NZCGF members as custodians of capital.

The Forum supports the Takeover Panel's regular reviews of New Zealand's market for corporate control as well as the current NZTP consultation process to seek the views of stakeholders as it considers changes to the current settings. We commend the Takeovers Panel for monitoring international experience. In response, the Forum has set up a sub-group (**Working Group**) to discuss the two consultation papers. The following comments reflect the initial views and considerations of the Forum's Working Group.

The Working Group generally supports the NZTP's view that the market for corporate control functions well (i.e., when offers are made, they are generally fair to all parties). However, we still have three major concerns resulting from the market's current strong preference for Schemes[1]:

1. Hostile transactions appear have become a rarity in New Zealand's markets, perhaps reflecting that they are perceived to be very difficult to effect relative to Schemes. We suggest there is further consideration of whether this obstructs the market for corporate control and thus jeopardises meeting the statutory objectives underpinning the Code, specifically §20(1).

2. The emphasis on Schemes moves the power to negotiate transactions from shareholders to boards. We have concerns that this creates a structural risk to optimising shareholder outcomes, where Scheme transactions are not well managed by boards:
    a. transactions which are in shareholders' interests may not presented to shareholders (as Schemes require the support of the Target Board),
    b. conversely, Boards can feel compelled to present an offer to shareholders despite having not yet maximised value in negotiations with the bidder, and
    c. shareholder perceptions of value can be hard to determine under a Scheme.

[1] Which is a result of the lower compulsory acquisition threshold in our opinion.

3. The rigidity of Schemes, once they are negotiated, makes it hard to accommodate changes – both in business conditions and in the perception of value. Specifically, our sense is that it is difficult for boards to fully represent shareholder interests under changing circumstances.

Regulatory Alignment of Schemes and Code Offers

The NZCGF supports the statutory objectives embedded in the Takeover Act and the role of the Takeovers Panel. Our experience is that the NZTP is accessible, skilled, maintains good relationships with all stakeholders.

While reflecting that Schemes and Code offers are distinct processes, and certain differences are expected (and desirable), the NZCGF Working Group supports the NZTP's objective of removing any illogical and inappropriate inconsistencies between Code and Scheme processes, given that the underlying shareholder rights issues are similar in both. Furthermore, we accept the need for the flexibility which Scheme offers provide, and therefore support the dual process structure.

We would suggest that in the first instance, the Takeovers Panel considers why Code offers are not more frequently used in the market and whether any of the Takeovers Code settings should first be adjusted before trying to create greater alignment between the Code and Schemes. For instance, we understand that the rigid requirements and timeframes around conditions are a significant barrier to utilising the Code in deals for corporate control.

We would like to see the Code objectives as set out in s20 of the Takeovers Act apply to transactions for control implemented by Schemes but recognise that the legal mechanism to achieve this is complex given the inherent structural difference between Schemes and Code offers and outside the scope of the review.

The Forum typically approaches matters from a shareholder rights perspective and advocates the principle that Boards (and Directors) and Management should be transparent and accountable to shareholders is a critical aspect of corporate governance. The Forum considers the Board-shareholder and Board-management relationships to be the most critical in the corporate governance of public companies, and that good corporate governance seeks to minimise the agency costs that arise in these relationships. As such, the Forum's Working Group has two material concerns regarding NZ's market for corporate control:

1. The general dominance of Schemes and the resulting effect of meeting the Code objectives.

2. Strengthening the disclosure obligations of directors to shareholders materially.

We would like to see disclosures strengthened so that shareholders get the appropriate information they need to make a good decision in relation to a takeover offer, under either the Code or by way of a Scheme. In addition, the Working Group feels that it would be beneficial for the Takeovers Panel to review current settings regarding Independent Advisor Reports in the same context – that is, whether such reports provide shareholders with the information they need to make good decisions.

Regarding the consultation questions, we note the following selective answers from the Working Group:

Q1: *Do you favour applying rule 64 to schemes?* The Working Group was unable to reach consensus on this issue.

Those in favour argued that the application of Rule 64 to Codes would lead to material advantages such as consistency between Code and Scheme offers and would provide a direct avenue to address misleading or deceptive conduct as the FMCA Fair Dealing Provisions was

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considered to be a little indirect and potentially lacking influence over all relevant parties (i.e., those other than target directors, the bidder and shareholders). They believed that the change would place the regulation appropriately in the hands of the NZTP, as the focus of the Takeovers Panel on the objectives of the Code (which support shareholders' interests in our view), its technical skills and its experience managing real-time takeover processes, would support shareholders receiving relevant and timely information which would enable quality decision-making.

Those not in favour argued that there is insufficient evidence (where this would have driven better shareholder outcomes) to warrant such a change. They also noted that there are important differences between Code offers and Schemes.

Q3: *If rule 64 is applied to schemes, do you prefer the Single Regulatory Approach or the Dual Regulatory Approach?* Those in favour preferred the Dual Approach, as this also allows for shareholder protections in Schemes provided by the FMCA. Their preference was also for the NZTP to be the primary regulator of takeover offers.

Q7: *Do you favour requiring the Relevant Disclosures in schemes?* Generally, yes, we support the NZTP having the power to force disclosures in-line with those required for Code offers. However, some members of the Working Group were of the view that such disclosures are already being made.SW

Q10: *Do you agree with applying the Code rules on acquisitions and disposals to schemes?* Yes. We support the protections for fair treatment of shareholders under the Takeovers Act applying to Schemes.

Q21: *Do you think the current Dominant Ownership Threshold remains appropriate?* The NZCGF Working Group considers that there is a strong case to review the current Settings, as part of a broader review to understand the reasons why Code offers are not more frequently used and whether changes would better realise the statutory objectives of the Code. The 90% Dominant Ownership Threshold in the Code may have had the effect of contributing to the lack of hostile takeovers, and our experience suggests that Target Issuers perceive that the lower threshold in Schemes to be a material factor driving their predominant use.

Deal Protection Devices

We support the Takeover Panel's review of deal protection devices. The NZCGF Working Group considers that the duty of directors is to maximise shareholder interests in the case of takeover offers. Furthermore, we generally support an open market process, meaning that boards should actively explore all options, including "business as usual", before narrowing down to one bidder.

The NZCGF Working Group notes the following regarding deal protection devices:

- There is a tension with deal protection devices, in that shares are the personal property of shareholders, and the duty of directors is to obtain the best outcome for shareholders. Deal protection devices can (if used incorrectly) constrain the free exercise of shareholder property rights.

- Although we are supportive of more specific rules around deal protection devices, we do not want to see a practice emerging whereby director duties are considered satisfied by compliance with those rules. We consider director duties to be a separate overlay; compliance with such rules would not necessarily result in the effective discharge of director duties.

- Shareholders will assess how effectively directors have fulfilled their functions as part of any takeover offer. As such, the Forum advocates for greater disclosure to better enable

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shareholders to understand and evaluate how decisions have been made on deal protection devices.

Regarding the consultation questions, we note the following selective answers from the Working Group:

Q1: *Do you agree that deal protection devices should be regulated (assuming that an appropriate standard can be developed)?* Yes. We believe this would support more fulsome consideration deal protection device agreements in the context of benefits and costs to shareholders.

Q2: *Do you agree that if there is to be any regulation of deal protection devices, it should apply to both Code offers and schemes?* Yes.

Q3: *Is there a stronger (or weaker) case for applying restrictions to: exclusivity arrangements; and/or break fees?* The NZCGF Working Group considers that for all deal protection devices it is important that the Takeovers Panel sets out the benefits and costs in the context of shareholder interests. That is, it is critical that the guidance from the Takeovers Panel focuses directors on the obligation of directors to agree to deal protection devices if, and only if, shareholders benefit from the relevant arrangement. The application of regulation will require flexibility appropriate to the specific deal protection device and underlying circumstances.

Q8: *Are there any standards that should apply to break fees (e.g., a restriction on quantum to 1% of deal value and/or a restriction on triggers)?* No. We believe that any limit would endorse the use of break fees up to the that limit. Concerning the use of break fees as deal protection devices, we note the policy of the Canadian Coalition for Good Governance (CCGG):

> *"Full Disclosure: Any board that agrees to a break fee should be prepared to justify it to shareholders with full disclosure and rationalization. Full disclosure of the terms of all "deal protection" should be provided in the directors' circular, subject to not disclosing competitive information which might damage the target's ability to negotiate with other bidders. Members will likely accept break fees negotiated by well advised, competent boards and rely on their business judgment to determine the amount and other provisions of the break fee. This recognizes that break fees have been upheld by the courts, are only one component of a complex transaction and will have been balanced by the board with other provisions of the deal. CCGG members do not wish to impose a single bright line test representing a tolerable maximum for break fees, but wish to make it clear that break fees will receive increasing scrutiny from institutional investors as the magnitude of the fee becomes larger and larger with deal sizes increasing."*

Q13: *Should the Panel look to address any other matters related to deal protection devices?* We believe that the Takeovers Panel should consider a robust guidance and disclosure regime which sets out the expectation that Boards should seek to maximize shareholder value and any decision to agree to deal protection devices should be disclosed and supported in that context. It is critical that a professional body, such as the NZTP, monitors the disclosures for completeness and cogency.

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Once again, the Forum appreciates the opportunity to consult with the Takeovers Panel on the potential for regulatory alignment of Schemes and Code offers, and deal protection devices.

Please note that this letter may be published on our website (www.nzcgf.org.nz) and LinkedIn page.

Yours sincerely,

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