CONSULTATION PAPER

Proposed amendments to the Takeovers Act, Takeovers Code and related legislation

29 June 2021

TAKEOVERS PANEL
TE PAE WHITIMANA

www.takeovers.govt.nz

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Glossary

In this paper, unless the context otherwise requires, capitalised terms have the meaning set out below:

Australian Panel	means the Australian Takeovers Panel
Code	means the Takeovers Code as set out in the schedule to the Takeovers Regulations 2000
Code company	has the meaning set out in section 2A of the Takeovers Act and rule 3A of the Code
Companies Act	means the Companies Act 1993
FMA	means the Financial Markets Authority
FMCA	means the Financial Markets Conduct Act 2013
NZX	means NZX Limited
NZSX	means the Main Board Equity Market operated by NZX
scheme	means a scheme of arrangement under Part 15 of the Companies Act 1993
Takeovers Act	means the Takeovers Act 1993
Unclaimed Money Act	means the Unclaimed Money Act 1971
Unlisted	means the Unlisted Securities Exchange

Introduction

1 The Panel is considering whether it should recommend a number of technical amendments to the Code and other legislation which relate to Code companies.

2 The Panel has prepared this consultation paper to seek the views of market participants so that the Panel can take these into account when deciding whether to make any recommendations.

Request for comments on this paper

3 The Panel invites submissions on the issues raised in this paper and the options identified for addressing those issues.

4 The closing date for submissions is Friday, 27 August 2021.

5 Submissions should be sent by email to the Panel for the attention of:

Eruera Harry-Reading
Associate
eruera.harry-reading@takeovers.govt.nz

Questions

6 If you have any questions in relation to the matters raised in this paper, you should feel free to contact the Panel executive team to discuss them. Please contact Eruera Harry-Reading (details above) in the first instance with any questions.

7 Should there be sufficient interest, the Panel executive may look to arrange a meeting with interested parties to discuss the proposals. If you think this would be of benefit, please let the Panel executive know as soon as possible.

Official Information Act 1982

8 Any submissions received are subject to the Official Information Act 1982. The Panel may make submissions available upon request under that Act. If any submitter wishes any information in a submission to be withheld, the submission should contain an appropriate request (together with a clear identification of the relevant information and the reasons for the request). Any such request will be considered in accordance with the Official Information Act 1982.

Structure of paper

9 There are two main sections to this paper.

Section One: Substantive Amendments

10 Section One contains five subsections that address more substantive amendments. Each subsection incorporates a framework and policy analysis similar to that found in Regulatory Impact Statements. The five subsections are:

(a) Definition of Code company: 12-month ‘look-back’ period.

(b) Update to rule 64 to reflect the FMCA.

(c) Court's power to grant mandatory injunctions.

(d) Making non-payment of consideration a breach of the Code.

(e) Financing of offers.

<u>Section Two: Lower Policy Content Amendments</u>

11 Section Two contains technical amendments of lower policy content, most of which address drafting anomalies or minor inconsistencies in the wording of the Code, or issues which have obvious fixes. The four subsections in Section Two are:

(a) Part 7 of the Code – unclaimed monies.

(b) Derivative disclosures.

(c) Amendments to the Personal Property Securities Act 1999.

(d) Rule 47(4) of the Code.

Policy Objectives

12 The Panel's objectives in considering the proposed amendments are the statutory objectives for the Code, as set out in section 20 of the Takeovers Act, namely:

(a) encouraging the efficient allocation of resources;

(b) encouraging competition for the control of Code companies;

(c) assisting in ensuring that the holders of financial products in a takeover are treated fairly;

(d) promoting the international competitiveness of New Zealand's capital markets;

(e) recognising that the holders of financial products must ultimately decide for themselves the merits of a takeover offer; and

(f) maintaining proper relation between the costs of compliance with the Code and the benefits resulting from it.

Section One: Substantive Amendments

Definition of Code company: 12-month 'look-back' period

Problem identification

13 Section 2A of the Takeovers Act defines a "Code company" as follows:

> *(1) **Code company** means a company –*
>
> *(a) that is a listed issuer that has financial products that confer voting rights quoted on a licensed market; or*
>
> *(b) that was within paragraph (a) at any time during the period specified in the takeovers code (being a period not exceeding the period of 12 months before any date or the occurrence of any event referred to in this Code); or*
>
> *(c) that –*
>
> *(i) has 50 or more shareholders and 50 or more share parcels; and*
>
> *(ii) is at least medium-sized.*
>
> *(2) [Repealed]*
>
> *(3) In this section, **shareholder** means a shareholder holding a financial product that confers a voting right.*
>
> *(4) In this section, a company is **at least medium-sized** if –*
>
> *(a) the company has completed 1 or more accounting periods and either or both of the following are true:*
>
> *(i) on the last day of the company's most recently completed accounting period, the total assets of the company and its subsidiaries (if any) are at least $30 million:*
>
> *(ii) in the most recently completed accounting period, the total revenue of the company and its subsidiaries (if any) is at least $15 million; or*
>
> *(b) the company has not completed its first accounting period and on the last day of the most recently completed month the total assets of the company and its subsidiaries (if any) are at least $30 million.*

14 The definition of "Code company" captures any company that has financial products that confer voting rights quoted on a licensed market, currently the NZSX (a **listed Code company**). If a listed Code company delists, that company will remain a Code company for 12 months after delisting (the **12-month look-back period**).

15 Unlike listed Code companies, there is no 12-month look-back period for unlisted Code companies (being unlisted companies with 50 or more shareholders and 50 or more share parcels and that are at least medium sized).

16 The 12-month look-back period that currently applies to listed Code companies was included in section 2A(1)(b) of the Act as an anti-avoidance measure to stop listed companies from delisting and then immediately undertaking a control-change transaction.

17 The Panel wishes to review the 12-month look-back period to determine whether it is operating appropriately.

Issues with all listed Code companies remaining Code companies after delisting

18 The Code continues to apply to all listed Code companies after delisting. Broadly speaking, there are two key scenarios in which a company might delist.[1] The Panel discusses below why it considers that the current operation of the definition of a Code company requires review:

(a) *Take private*

Most commonly, Code companies delist after a “take private” transaction (whether by a takeover offer followed by compulsory acquisition or by a scheme of arrangement). In this scenario, the voting rights in the Code company will be held by one shareholder (or two or more shareholders acting jointly or in concert for the purposes of the “take private” transaction).

Despite the fact that after such a transaction the company is privately owned, the 12-month look-back period applies and for the next 12 months the company will remain a Code company.

In those circumstances there are no minority shareholders who would benefit from the Code’s protections. Any additional compliance costs in this scenario would outweigh the benefit.

(b) *Company moves off the NZSX*

Less commonly, a Code company might simply terminate its listing agreement with NZX. This may or may not be coupled with a move to another exchange such as Unlisted. Unlisted is not a “licensed market” for the purposes of the section 2A(1)(a) of the Act, so companies whose securities trade on Unlisted are not automatically Code companies. However, it is possible that a company that moves from NZSX to Unlisted would remain a Code company (irrespective of the 12-month look-back period) because of its wide shareholding and size.

In contrast to a “take private” transaction, the Panel sees merit in the Code continuing to apply to companies that opt to terminate their listing agreement. For example, shareholders would continue to enjoy the rights and protections of the Code for a period of time while they consider whether to continue to hold an interest in an unlisted company.

However, if a listed Code company wishes to delist with NZX and is removed from the NZSX, there are several levels of compliance that must be satisfied before NZX will approve the proposed delisting. NZX’s *Practice Note: Delisting Process for Equity Issuers* outlines the process for delisting. For example, shareholder approval may be required before NZX permits a company to delist. Therefore, shareholders already have a degree of protection against arbitrarily losing the Code’s protections when a company seeks to delist.

Accordingly, the Panel considers that if a company chooses to delist (other than after a “take private” transaction), it may be appropriate to dispense with the 12-month look-back period if shareholders approve this by an appropriate majority.

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[1] A company might also delist in the case of insolvency, but as such a company will be wound up, the Panel does not consider it relevant for this purpose.

Issues with no 12-month look-back period applying to unlisted Code companies

19 The Panel accepts that Code companies can restructure their shareholdings so that they cease to be Code companies. A common structure to effect this change is the use of a nominee that holds shares on trust for a number of beneficial owners, bringing the total number of shareholders and/or share parcels under 50 (a **Nominee Structure**).

20 However, the current definition of Code company could allow an unlisted company to move in and out of the Code. While some movement in and out of Code company status is likely inevitable, the Panel has concerns that this may be administratively cumbersome and open to avoidance structures / tactics (such as using a Nominee Structure to avoid the Code immediately prior to a control-change transaction).

21 The Panel considers that the rationale that underpins the 12-month look-back period appears to be better suited to unlisted companies than to listed companies.

22 However, the Panel is again conscious that in some cases the 12-month look-back period may not be appropriate. The Panel considers this can be addressed by shareholders having an appropriate level of control over a Company dispensing with the 12-month look-back period for unlisted Code companies.

Options for reform

Summary of options

23 The following options have been identified:

(a) Option 1 maintains the status quo.

(b) Option 2 removes the 12-month look-back period following a full takeover offer or scheme of arrangement (or other "take private" transaction) that results in a listed company being controlled by one shareholder or two or more shareholders acting jointly or in concert for the purposes of the transaction.

(c) Option 3 (the Panel's preferred option), is the same as Option 2, but also:

(i) institutes a 12-month look-back period for unlisted Code companies; and

(ii) allows shareholders to opt out of the 12-month look-back period.

Option 1: maintain status quo

24 If the status quo is maintained, the 12-month look-back period would continue to apply to listed Code companies and would not apply to unlisted Code companies.

25 The advantages of maintaining the status quo are that:

(a) it is understood by the market; and

(b) shareholders in listed Code companies will still be afforded Code protections following delisting.

26 The disadvantages of maintaining the status quo are discussed within paragraphs 18 - 20 above.

27 In assessing Option 1 against the policy objectives of the Code (see the Policy Objectives section above), the Panel thinks that the current 12-month look-back period regime is not working in the most effective way. Accordingly, Option 1 is the Panel's least preferred option.

Option 2: remove the 12-month look-back period following "take private" transactions

28 An offeror who has successfully made a full takeover bid for a listed Code company, with the intention of delisting and taking the business private, will not be caught by the 12-month look-back period. Successful offerors will hold or control 100% of the shares on issue.

29 The Panel thinks that this is appropriate as the 12-month look-back period does not provide shareholders with any added protections after a "take private" transaction. Rather, it places an unnecessary compliance cost on what has become a private company.

30 The advantage of Option 2 is that it would remove unreasonable compliance costs without creating any disadvantages for shareholders. The disadvantage of Option 2 is that it provides less flexibility than Option 3.

31 Option 2 aligns with the policy objectives of the Code to a moderate degree as it would better maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Option 3: implement Option 2, plus (a) a 12-month look-back period for unlisted Code companies; and (b) an ability for shareholders to opt out of the 12-month look-back period

32 Option 3 is the Panel's preferred option. It provides a benefit to both listed and unlisted Code companies and their shareholders.

33 The advantages of Option 3 (as it relates to listed Code companies) are as follows:

(a) As with Option 2, Option 3 removes an unnecessary compliance cost after a 'take private' delisting without creating any disadvantages for shareholders.

(b) If a Code company wishes to cease being a Code company other than as a result of a 'take private' transaction, then shareholders can vote to decide whether to opt out of the Code or not.

34 The advantages of Option 3 (as it relates to unlisted Code companies) are that shareholders will have the protections afforded under the Code for 12 months following any restructure that is not approved by an appropriate majority. Accordingly, shareholders would not lose their rights under the Code simply because (for example) a group of shareholders decide to move their shares into a Nominee Structure (with the purpose of avoiding the costs of Code compliance).

35 As to the shareholder approval threshold for opting out of the 12-month look-back period, the Panel thinks that it is appropriate to set a high voting threshold for resolutions approving a company's decision to structure out of the Code on the basis that it is, in effect, removing the statutory rights of minority shareholders. As such, the Panel considers that the voting threshold should reflect section 236A(4) of the Companies Act (for approval of schemes of arrangement), being:

(a) 75% of the votes of the shareholders entitled to vote and voting on the resolution; and

(b) by simple majority of the votes of those shareholders entitled to vote.

36 In considering how Option 3 meets the objectives of the Code, Option 3:

(a) encourages the efficient allocation of resources;

(b) assists in ensuring that the holders of financial products in an unlisted Code company will be treated more fairly;

(c) recognises that the holders of financial products must ultimately decide for themselves the merits of a structuring out of the Code; and

(d) maintains a proper relationship between the costs of compliance with the Code and the benefits resulting from it.

Questions: Definition of "Code company": 12-month look-back period	
Number	**Question**
1.1	Is Option 1, Option 2, or Option 3 your preferred option? Please give reasons.
1.2	What problems or benefits are there with either Option 1, Option 2 or Option 3 that are not identified in this paper or in your other responses?
1.3	What voting threshold (if any) do you consider to be appropriate for opting out of the 12-month look-back period?

Update to rule 64 to reflect the FMCA

Problem identification

Current position

37 Rule 64 of the Code states the Code's prohibition against misleading or deceptive conduct, as follows:

> ***64 Misleading or deceptive conduct***
>
> *(1) A person must not engage in conduct that is—*
>
> *(a) conduct in relation to any transaction or event that is regulated by this code; and*
>
> *(b) misleading or deceptive or likely to mislead or deceive.*
>
> *(2) A person must not engage in conduct that is—*
>
> *(a) incidental or preliminary to a transaction or event that is or is likely to be regulated by this code; and*
>
> *(b) misleading or deceptive or likely to mislead or deceive.*

38 The corresponding prohibitions against misleading or deceptive conduct under the FMCA are set out in sections 19 – 23 of the FMCA.

39 Section 19 of the FMCA provides as follows:

> ***19 Misleading or deceptive conduct generally***
>
> *(1) A person must not, in trade, engage in conduct that is misleading or deceptive or likely to mislead or deceive in relation to—*
>
> *(a) any dealing in financial products; or*
>
> *(b) the supply or possible supply of a financial service or the promotion by any means of the supply or use of financial services.*
>
> *(2) A person must not engage in conduct that is misleading or deceptive or likely to mislead or deceive in relation to any dealing in quoted financial products.*
>
> *(3) Subsection (2) applies regardless of whether or not the dealing is in trade.*

40 Sections 20 to 22 of the FMCA prohibit a person from, in trade, engaging in conduct that may mislead the public as to the nature, characteristics, suitability or quantity of financial products or financial services. The Panel considers that these sections are specific to the issuing / advising in respect of the issuance of financial products and are not directly applicable to Code-regulated transactions.

41 Section 23 of the FMCA provides as follows:

> ***23 Unsubstantiated representations***
>
> *(1) A person must not, in trade, make an unsubstantiated representation.*

*(2) A representation is **unsubstantiated** if the person making the representation does not, when the representation is made, have reasonable grounds for the representation, irrespective of whether the representation is false or misleading.*

(3) This section does not apply to a representation that a reasonable person would not expect to be substantiated.

*(4) In this section and sections 24 to 27, **representation** means a representation that is made—*

(a) in respect of financial products or financial services; and

(b) in connection with—

(i) any dealing in financial products; or

(ii) the supply or possible supply of financial services or the promotion by any means of the supply or use of financial services.

42 Accordingly, the FMCA provides more comprehensive prohibitions against misleading or deceptive conduct than are provided under rule 64 of the Code through the restriction on unsubstantiated representations (although both seek to prevent holders or purchasers of financial products from being misled or deceived). In the Panel's view:

(a) Sections 20 – 22 of the FMCA relate to issues that are relevant to the issue of securities or other transactions where securities or financial advice are being provided. It is unclear how these would be replicated in relation to takeovers (or what benefit this would convey).

(b) However, it may be appropriate to adopt an equivalent provision to section 23 in order to align the Code with the FMCA and provide the same protections to shareholders in respect of Code-regulated transactions and events.

Legislative background

43 Rule 64 is based on section 9 of the Fair Trading Act 1986 (the **FTA**). The FTA provided a basis for corresponding provisions in financial markets legislation. However, when those related provisions came into effect (or were updated) to provide comprehensive protections against misleading or deceptive conduct, the Code was not updated.

44 The legislative history is as follows:

(a) In 1986, the FTA was enacted. Relevantly, it prohibited:

(i) misleading or deceptive conduct in trade generally (section 9);

(ii) misleading conduct, in trade, in relation to goods and services (sections 10 and 11); and

(iii) false or misleading representations by persons, in trade, in connection with the supply or promotion of goods or services (section 13).

(b) In 1993, the Takeovers Act was enacted. The Code, which came into force in 2001, did not contain rule 64. Instead, regulatory oversight of misleading and deceptive conduct in respect of takeovers was under the FTA, with the Commerce Commission being the relevant regulator.

(c) On 29 February 2008, rule 64 was introduced into the Code. The FTA and the Takeovers Act were amended so that the FTA no longer applied to conduct in relation to Code-regulated transactions or events, with the Panel assuming jurisdiction.

(d) On the same day, the Securities Markets Act 1988 was amended to prohibit (among other things):

(i) false or misleading statements or information likely to have certain effects in relation to securities of listed companies (section 11); and

(ii) misleading or deceptive conduct in relation to any dealings in securities of listed or non-listed companies (section 13).

These two sections did not apply to conduct in relation to takeover offers, to the extent that the conduct was regulated by the Code or the Takeovers Act. Accordingly, at this point, the regulation of secondary markets trading in securities and takeovers specifically was aligned as it related to misleading and deceptive conduct.

(e) In 2011, the FMA was established. The FMA's powers and duties were conferred under various statutes, including the Securities Markets Act 1988.

(f) In 2013, the FMCA came into effect. Sections 19 – 22 of the FMCA were based on sections 9, 10, 11 and 13 of the FTA and section 13 of the Securities Markets Act 1988. Section 23 of the FMCA was also included (not having had a direct precedent in the FTA prior to its introduction).

(g) In June 2014, a provision similar to section 23 of the FMCA was incorporated into the FTA (section 12A).

(h) In December 2014, the Securities Markets Act 1988 and various other Acts were repealed and replaced by the FMCA.

Conclusions

45 Despite the similar origins to the relevant provisions of the FMCA and the Code, and efforts to align the FTA and FMCA, rule 64 of the Code was not updated to align with the corresponding provisions of the FMCA. The Panel is not aware of any reason for this.

Panel seeks views on this issue

46 The Panel is unsure how significant the differences between the FMCA and the Code are in practice, and whether the costs of reform would outweigh any benefits. Accordingly:

(a) The Panel has not formed a view on a preferred approach at this stage.

(b) The Panel would like to hear the views of a broader range of market participants before deciding on a preferred option for reform.

Options for reform

Summary of options

47 The Panel sees two options for reform:

(a) Option 1 maintains the status quo.

(b) Option 2 would amend the misleading or deceptive conduct provisions of the Code by including a restriction on unsubstantiated statements.

Option 1: maintain status quo

48 In considering how Option 1 meets the objectives for the Code, the Panel thinks Option 1 does not adequately ensure that the holders of financial products in a takeover are treated fairly. Similarly, it may not promote the availability of reliable information, and therefore does not adequately recognise that the holders of financial products must ultimately decide for themselves the merits of a takeover offer.

49 The Panel notes that Option 1 may make Code-compliant document preparation easier (compared with Option 2). However, the Panel understands that document verification occurs currently.

Option 2: update the Code to align its provisions against misleading or deceptive conduct with the corresponding provisions of the FMCA

50 In considering how Option 2 meets the objectives for the Code, the Panel thinks that Option 2:

(a) assists in ensuring that the holders of financial products in a takeover are treated fairly by ensuring receipt of accurate disclosures; and

(b) recognises that the holders of financial products must ultimately decide for themselves the merits of a takeover offer and that shareholders should be afforded potentially greater protection against misleading or deceptive information.

51 At this stage, the Panel is unclear whether Option 2 would maintain a proper relationship between the costs of compliance with the Code and the benefits from it, i.e., whether it would appropriately balance the benefit to shareholders of Code companies being provided with greater protections against misleading or deceptive conduct against the potential costs of the obligation on persons to ensure that conduct and statements are not misleading or deceptive.

Questions: Update to rule 64 to mirror the FMCA	
Number	**Question**
2.1	Do you consider that there is a sound basis for not having a restriction on unsubstantiated statements in the Code? If so, please explain your reasons.
2.2	Is Option 1 or Option 2 your preferred option? Please give reasons.
2.3	What problems or benefits are there with either Option 1 or Option 2 that are not identified in this paper or in your other responses?

Court's power to grant mandatory injunctions

Problem identification

52 The Takeovers Act empowers the High Court to make certain orders following a determination by the Panel that it is not satisfied that a person has acted or is acting or intends to act in compliance with the Code (a **Non-compliance Determination**).

53 The current drafting of section 33F of the Takeovers Act may be too narrow, restricting the Court's ability to grant mandatory injunctions.

Issues with the current drafting of section 33F of the Takeovers Act

Background

54 If the Panel considers that a person may not have acted or may not be acting or may intend not to act in compliance with the Code, the Panel may convene a meeting under section 32 of the Takeovers Act. Following the section 32 meeting, the Panel may make a Non-compliance Determination.

55 Once a Non-compliance Determination is made, the Panel may (among other things) apply to the High Court for an injunction (section 33F), a civil remedy order (section 33I), or a compensation order (section 33K). Other parties referred to in section 35(1) of the Takeovers Act may also apply to the Court for such orders, subject to certain limitations.

56 Section 33F of the Takeovers Act states:

> *The court may, on application by any person in accordance with section 35, grant an injunction restraining a person from engaging in conduct that constitutes or would constitute a contravention of the takeovers code.*

57 It is not clear whether the Court has the jurisdiction to grant a "mandatory injunction" under section 33F. To explain:

(a) The inclusion of the word "restraining" in section 33F suggests that it confines the Court to making a "prohibitory injunction" rather than a "mandatory injunction". Sim's *Court Practice* defines these terms as follows:[2]

> ***Prohibitory injunction:*** *Restrains the person to whom it is addressed from doing something.*
>
> ***Mandatory injunction:*** *Orders the person to whom it is addressed to do something in the nature of a positive act.*

(b) Accordingly, the Court may only have the power to grant an injunction ordering a person to stop or to prevent a person from engaging in particular conduct that contravenes or may contravene the Code. If this is correct, the Court does not have the power to order a person to take a positive action.

(c) To some degree, this issue can be resolved through the Court granting civil remedy orders under section 33I of the Takeovers Act. However, the scope of civil remedy orders is naturally limited. Accordingly, there may be positive actions that could be appropriate, for which there is no ability to make a civil remedy order. The examples are set out below.

[2] Sim's Court Practice at API.4.

58 Should section 33F be limited in the manner described above, there would be a lack of jurisdiction for a Court to make orders that could well be appropriate. For example:

(a) If a shareholder had publicly indicated on an unconditional basis that they would accept an offer, but subsequently refused to do so:

(i) The Court may not have the jurisdiction to order the person to accept the offer.

(ii) The Panel may not have jurisdiction to make a permanent compliance order to this effect (see section 33AA).

(iii) There is no civil remedy order that directly addresses the situation (see section 33J).

(iv) Punitive action may be available, but this may be a less appropriate remedy than simply compelling a person to act in accordance with their public statements.

(b) If, during the course of a takeover, a third party states unconditionally that (i) they will be making a takeover for the target; and (ii) that shareholders should therefore not accept the current offer, then the initial takeover may not succeed because shareholders were waiting for the higher offer. If the third party does not make the offer, then it is not clear that the Court has the power to require the third party to follow through with their public statement.

59 Accordingly, the issue is whether the Court should have the power to grant a mandatory injunction ordering that a person take a positive action in the context of a potential breach of the Code.

<u>Options for reform</u>

60 The options considered by the Panel are as follows:

(a) Option 1 maintains the status quo.

(b) Option 2 amends the Takeovers Act to expressly provide the Court the power to grant mandatory injunctions.

Option 1: maintain status quo

61 The disadvantages of maintaining the status quo are that:

(a) It is unclear whether or not a Court can grant a mandatory injunction.

(b) There are potential circumstances in which the Court may not be able to grant a remedy that is appropriate in those circumstances.

62 In assessing Option 1 against the policy objectives of the Code, Option 1 does not maintain a proper relationship between the costs of compliance with the Code and the benefits resulting from it.

Option 2: amend the Takeovers Act to include that the Court can grant mandatory injunctions

63 This is the Panel's preferred option as:

(a) This option removes the current uncertainty as to the Court's jurisdiction.

(b) This option provides a wider range of remedies to respond to potential Non-compliance Determinations.

64 The Panel considers the discretionary nature of relief to be appropriate – this provides an appropriate level of protection to any potentially affected party.

65 The Panel sees this as preferable to expanding the list of potential civil remedies in section 33J as it retains flexibility to deal with situations as they arise (with the Court's discretion protecting against inappropriate remedies).

66 Option 2 aligns with the policy objectives of the Code as it would better maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Questions: Court's power to grant mandatory injunctions	
Number	**Question**
3.1	Is Option 1 or Option 2 your preferred option? Please give reasons.
3.2	What problems or benefits are there with either Option 1 or Option 2 that are not identified in this paper or in your other responses?

Making non-payment of consideration a breach of the Code

Problem identification

Introduction

67 The Code provides that an offer must specify when the consideration for the offer must be sent to the persons whose financial products are taken up under the offer.[3]

68 The remedy for non-payment of consideration under the Code is set out in rule 34, which provides that if an offeror does not send the consideration within the period specified in the offer, the persons who were not paid may withdraw their acceptance of the offer. Mechanically, the process works as follows:

(a) If payment has not been made when due, the relevant financial product holder may give written notice to the offeror of their intention to withdraw their acceptance of the offer (a **Withdrawal Intention Notice**).

(b) The Withdrawal Intention Notice effectively initiates a 5 working day cure period, within which the offeror may pay the consideration without breach of the offer terms or the Code (if payment is made within this period, no further consequence arises as a result of the failure to pay consideration when due).

(c) At the expiry of the cure period (i.e., no fewer than 5 working days after giving the Withdrawal Intention Notice) the relevant financial product holder may give written notice to the offeror withdrawing acceptance of the offer.

69 It is common for the provisions described above to be incorporated in the terms of an offer, making them also a contractual obligation. Shareholders may be able to enforce this contractual obligation through the Court.

70 Outside of this contractual remedy, non-payment of consideration to a shareholder is not a breach of the Code. It is possible that failure to pay consideration may give rise to other breaches of the Code (e.g., misleading or deceptive conduct under rule 64 of the Code – see further below). However, non-payment is not a breach of the Code in and of itself.

71 The Panel's starting point on this issue is that payment of consideration is a fundamental part of a public acquisition. The Panel is concerned that, given the critical nature of the payment obligation, the current position does not adequately protect shareholders or adequately address broader concerns related to market integrity.

Issues with enforcing contractual remedies

72 In a public transaction, where shareholder bases are diffuse, significant practical issues would likely arise with suing for failure to pay offer consideration. For example:

(a) litigation may not be an economic alternative for smaller shareholders despite the aggregate amount at stake being greater; and

(b) litigation may be complicated by a number of factors such as shareholders potentially having different losses.

73 Further, should payment be made late (rather than not at all), it is possible that interest could be recovered through the Court as well. However, it is not market practice to include an obligation to pay interest on any

[3] Rule 33(1) of the Code.

late payment. Accordingly, the precise contractual remedy for late payment is not clearly articulated. This limits the effectiveness of litigation as a disincentive to late payment.

74 The effect of these practicalities is that, while litigation may be an effective remedy in a private acquisition, these unique features of a public transaction make it a more problematic alternative for shareholders.

Market integrity issues

75 A failure to pay consideration would cause broader issues and likely undermine confidence in the market as a whole:

(a) In the first instance, the difficulties involved with pursuing contractual remedies means litigation is unlikely to be an attractive option for shareholders, particularly smaller shareholders.

(b) The process for takeovers under the Code does not sit well with shareholders withdrawing acceptances. For example, if an offeror receives acceptances taking the offeror over 90% control, then the compulsory acquisition provisions of Part 7 of the Code are engaged. Unwinding these rights and obligations after acceptances are withdrawn may be complicated.

(c) If some shareholders are paid on time and some are not, then only the shareholders who are not paid on time have the right to withdraw their acceptances in accordance with the Code.

(d) Finally, the Code does not allow offers to be made on conditions that are within the control of the offeror. This is intended to stop offerors from unilaterally withdrawing an offer (i.e., to stop an offer from becoming an 'option' that an offeror can elect to take or reject at any time during the offer period). If the only remedy for non-payment is an uncertain contractual remedy which must be sought by shareholders through the courts, then in theory offerors could elect to take the option of non-payment and withdrawal of acceptances under the offer and risk potential legal action.

76 At a more basic level, a failure to make payment would be a significant issue for the functioning of an efficient takeovers market. This is a basic obligation and offerors that do not meet it should be at risk of pecuniary penalties and/or management bans, and this should not be dealt with solely in the conditions of the offer.

<u>Options for reform</u>

Summary of options

77 The following options have been identified for addressing the problem:

(a) Option 1 maintains the status quo.

(b) Option 2 amends the Code so that the Code itself requires payment of consideration at the relevant time (meaning a failure to do so would be a breach of the Code).

Option 1: maintain status quo

78 If the status quo is maintained, there would be no specific rule under the Code for non-payment of consideration by an offeror. The Code's mechanism that allows acceptances to be withdrawn gives the Panel limited options for enforcing non-payment of consideration. Any private enforcement for non-payment as a matter of contract is unlikely to be effective.

79 The Panel does not see any advantage to maintaining the status quo.

80 In considering how Option 1 meets the objectives for the Code, the Panel thinks that Option 1 does not maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it, nor does it promote the fair treatment of shareholders.

Option 2: amend the Code to include a new rule specifying payment of consideration under an offer

81 Option 2 provides a direct avenue for the Panel to determine non-payment of offer consideration to be a breach of the Code. A breach of Code may give rise to remedies under the Takeovers Act.

82 The Panel does not see any disadvantage of Option 2. However, before the Panel chooses a preferred option, it wishes to seek the views of market participants and assess the extent of this issue.

83 In considering how Option 2 meets the objectives for the Code, the Panel thinks that Option 2 helps maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it and promotes fair treatment of shareholders.

Questions: Making non-payment of consideration a breach of the Code	
Number	**Question**
4.1	What other problems and/or benefits are there with either Option 1 or Option 2 that are not identified in this paper or in your other responses?
4.3	Is Option 1 or Option 2 your preferred option? Please give reasons.

Financing of offers

Problem identification

Introduction

84 As discussed above, it is important for market integrity that payment of consideration is made when due. A natural corollary of this is ensuring that the offeror has access to the relevant funds.

85 The Code does not place a direct obligation on an offeror to have the resources available to pay the consideration to be provided under the offer (or other related amounts). Nor does the Code require any disclosure of the financing arrangements so that offerees can understand the counterparty / completion risk to which they are exposed.

86 Instead, the Code simply requires that an offeror include a confirmation that the resources will be available. Clause 9(1) of Schedule 1 to the Code states that an offeror must provide:

> *Confirmation by the offeror that resources will be available to the offeror sufficient to meet the consideration to be provided on full acceptance of the offer and to pay any debts incurred in connection with the offer (including the debts arising under sections 47 to 53 of the [Takeovers] Act).*

87 If this confirmation is misleading or deceptive (because the offeror does not in fact have adequate resources), then rule 64 of the Code, which prohibits misleading or deceptive conduct, may be breached. This breach could extend to the offeror and to the offeror's directors and officers who confirm that the Schedule 1 disclosure is accurate. However, there are uncertainties in applying rule 64 in these circumstances. For example, it may not be clear what level of committed funding is sufficient to allow the required statement to be made. Although the Panel's *Guidance Note on Offer Documents and Variations* provides (at paragraph 4.16) that "the grounds upon which the financial arrangements would be withdrawn would need to be very limited so that the offeror can be confident that the finance will in fact be available", some uncertainty may remain.

Issues related to debt funding

88 As to what level of certainty is required to make the clause 9(1) statement, the Panel understands that some offerors have formed the view that it is not necessary to have even an agreed term sheet with a debt funder prior to launching an offer. In the absence of existing and adequate committed undrawn facilities and/or cash in bank, this view does not appear to be consistent with the Panel's guidance.[4]

89 The Panel notes that to date there has been no case of an offeror having been unable to complete a takeover transaction for lack of funding. However, there is an example of a Code-regulated shareholder approved transaction that did not complete when funding was withdrawn. The proposed allotment of voting securities by Silver Fern Farms Limited to PGG Wrightson Limited in 2008 did not complete when PGG Wrightson's bank funding was withdrawn.

90 There were concerns that credit conditions similar to those in the global financial crisis in 2008 could have arisen in 2020. It appears possible that this could occur again in the future, whether as a result of further disruptions to financial markets or, more simply, an offeror having inadequately robust funding arrangements.

[4] The Panel reserves its position on whether this practice is compliant with the Code (noting that any issue would need to be assessed in all the relevant circumstances).

Accordingly, the Panel wishes to assess whether the current policy framework relating to the financing of offers is up to date.

Issues related to equity funding

91 As to equity funding, offerors should have robust arrangements in place to ensure that commitments made in (or incurred in connection with) a takeover offer can be met when they fall due.

92 In particular, the Panel is aware that issues may arise in relation to private equity / financial buyers. While most offerors will typically incorporate a special purpose vehicle (a "**bidco**") to make a takeover offer (generally with little equity at the time an offer is made), the Panel understands that private equity bidcos will seldom have the benefit of a "vanilla" parent company guarantee. Rather, private equity bidcos will generally be party to (or have the benefit of) "equity commitment letters" or similar, from funds that will invest in the bidco (or another special purpose vehicle upstream of the bidco) on or around completion.

93 Equity commitment letters present several issues:

(a) The Panel understands that the terms of equity commitment letters (and the level of protection that they provide to shareholders) vary, making it difficult for shareholders to understand the counterparty risk.

(b) The Panel understands that there can be practical issues with target company shareholders enforcing obligations under equity commitment letters:

(i) Shareholders will likely not have a direct claim against the underlying fund. Rather, shareholders will likely have a claim against bidco.

(ii) Even if the shareholders' claim is successful, bidco might not pursue its claim against the underlying funds with the same vigour as the shareholders might.

(iii) Practically, this might result in shareholders having to sue to liquidate bidco in the hope that the liquidator will effectively pursue the claim against the underlying funds, if legally feasible. If private equity funds are incorporated (and their assets are located) in foreign jurisdictions, there can be practical difficulties in terms of enforcement, such as:

(A) Effecting service on underlying funds domiciled outside of New Zealand may be problematic.

(B) Any judgment award would need to be enforced in a foreign jurisdiction.

(C) Foreign legal systems may be insufficiently robust to provide adequate certainty that judgments would be enforced.

(D) The assets of the relevant fund may be protected against claims via limited liability structures.

(c) While financial buyers may be incentivised to complete transactions where a judgment orders them to do so, for fear of not being able to enter into future transactions:

(i) this provides little formal protection to shareholders;

(ii) the reliance on the practical incentives are likely to not be fully appreciated by shareholders; and

(iii) moreover, the Panel is concerned that a bidco (or parties upstream of / controlling the bidco) might be able to effectively choose to not proceed with an otherwise unconditional transaction.

(d) In some cases, should an "agreed" transaction not proceed, equity commitment letters will only provide bidco with funding sufficient to cover the reverse break fee. Accordingly, should a bidco fail to complete a transaction and be liable for an amount greater than the reverse break fee, bidco would likely not have a right to obtain such funds from the underlying funds.

International practice – introduction

94 The New Zealand regime provides significantly less assurance to shareholders than comparable international regimes (for example Australia and the UK). These differences are outlined below.

95 As an introductory comment, the Panel is cognisant of the argument that requiring more certainty of funding would result in additional funding costs for offerors and that this will reduce the frequency of takeovers in New Zealand. The Panel notes that international experience suggests that more robust regimes do not inhibit takeover activity. The Panel considers that additional costs on offerors should be weighed against the benefits to the market and for shareholders when considering whether the New Zealand position should be reformed.

International practice – Australia

96 In Australia, there is no specific legislative provision that places an obligation on an offeror to ensure that funding arrangements are in place. Rather, an offeror with insufficient funding in place risks defeating the principle in section 602(a) of the Corporations Act 2001, which provides that acquisitions of control over voting shares *must take place in an efficient, competitive and informed market*. Accordingly, the issue is dealt with by the Australian Takeovers Panel as a question of whether or not the lack of sufficiently certain funding constitutes unacceptable circumstances.

97 The Australian Takeovers Panel's *Guidance Note 14* (the **Guidance Note**) sets out the Australian Panel's guidance for funding arrangements. The Guidance Note provides the framework and policy basis for how the Australian Takeovers Panel approaches these matters.

98 The Guidance Note states:[5]

> *A bidder may fund its bid from any source, internal or external. It may have a combination of sources. It may also have alternative arrangements in place (eg, it has cash reserves but seeks debt funding). If alternatives are disclosed, each must be in place or provide a reasonable basis for the bidder to expect that it will be in place.*

99 The Guidance Note also provides that if an offeror does not have funding in place, or a reasonable basis to expect that it will have funding in place for all acceptances when the bid becomes unconditional, this may give rise to unacceptable circumstances. In considering what is a reasonable basis, the Guidance Note outlines that "reasonable basis" is assessed objectively and will depend on the circumstances of each case.

100 The Guidance Note sets out criteria for what is required of an offeror in proving that funding arrangements are in place. This includes a broader level of disclosure than that currently required under the Code. For example, the Guidance Note sets out what an offeror should consider disclosing, including:

(a) Establishing that the bidder's funder has the necessary financial resources. If the funder is an Australian bank, this may require only that it be identified. For other financial institutions, there may need to be limited disclosure (e.g., its latest audited net assets and a description of its prudential regulation). For other funders, more disclosure may be needed (e.g., full accounts, or in most cases an accountant's

[5] *Guidance Note 14* – Funding arrangements at paragraph 5.

certificate as to its ability to meet the obligation with disclosure of the content of the accountant's certificate or enough of it to allow shareholders to be satisfied of the sufficiency of the arrangements).

(b) If the funder is a group member, the terms of the intra-group arrangements.

(c) The amount available for drawdown, or under alternative or stand-by funding, or available by way of any other sources of cash or non-cash assets relied on (and arrangements for realisation of non-cash assets). The Australian Takeovers Panel's guidance is that documentation relating to funding arrangements should be completed and signed before offers are sent to target shareholders. Such documentation may include an executed loan or other financing documents, although a facility, commitment letter or term sheet may be acceptable if it is binding and sets out all material conditions.

(d) Material changes to funding terms or to circumstances that affect the availability or sufficiency of the arrangements.

101 The terms of the funding arrangement (interest rate, repayment, covenants, security) may not need to be disclosed unless the bid is likely to result in a continuing minority shareholding in the target.

United Kingdom – City Code on Takeovers and Mergers

102 As an introductory comment (as explained further in the conclusions below) the Panel is conscious that the UK regime is quite different from that in New Zealand or Australia. Accordingly, it is presented here mainly as a comparison to show the extent of shareholder protection provided in a key overseas jurisdiction.

103 Rule 2.7(a) of the City Code on Takeovers and Mergers (**City Code**) provides:

> *An offeror should announce a firm intention to make an offer only after the most careful and responsible consideration and when the offeror has every reason to believe that it can and will continue to be able to implement the offer. Responsibility in this connection also rests on the financial adviser to the offeror.*

104 Rule 24.8 of the City Code states:

> *When the offer is for cash or includes an element of cash, the offer document must include confirmation by an appropriate third party (eg the offeror's bank or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer (The party confirming that resources are available will not be expected to produce the cash itself if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash was available.)*

105 Rule 24(f) of the City Code states (referring to when an offeror is a UK-listed company):

> *The offer document must contain a description of how the offer is to be financed and the source(s) of the finance. Details must be provided of the debt facilities or other instruments entered into in order to finance the offer and to refinance the existing debt or working capital facilities of the offeree company and, in particular:*
>
> *(i) the amount of each facility or instrument;*
>
> *(ii) the repayment terms;*
>
> *(iii) interest rates, including any "step up" or other variation provided for;*
>
> *(iv) any security provided;*

> *(v) a summary of the key covenants;*
>
> *(vi) the names of the principal financing banks; and*
>
> *(vii) if applicable, details of the time by which the offeror will be required to refinance the acquisition facilities and of the consequences of it not doing so by that time[.]*

106 Practice statement 10 of the City Code deals with cash offers financed by the issue of offeror securities. It states:

> *In order to satisfy Rules 2.7(a) and 24.8, it is the responsibility of the party giving the cash confirmation and the offeror (and, if it is not the cash confirmer, the offeror's financial adviser) to take all reasonable steps, before announcement of the offer, to satisfy themselves that the issue of the new securities will be successful, and that the offeror will have the necessary cash available to finance full acceptance of the offer.*

107 The Panel's understanding is that in the UK a financial adviser providing a cash confirmation will conduct extensive due diligence on the offeror's resources / funding arrangements. This is because if the adviser has failed to act responsibly and take all reasonable steps to assure itself that the cash was available, then the adviser will be liable for payment should payment not be made by the offeror. The party giving the cash confirmation will customarily appoint external legal counsel to carry out this due diligence process (with the offeror typically bearing these costs). In contrast to the Australian approach, the City Code requires less disclosure.

108 Accordingly, the UK approach goes further than Australia, providing an additional layer of protection. This has the benefit of allowing the regime to adapt to new structures such as private equity. While the Australian practice is tied to disclosure which must be kept up to date with movements in the market, the UK approach places the onus on the offeror's financial adviser to assume a level of risk when providing a cash confirmation. Providers of cash confirmations are incentivised to ensure that appropriate funding arrangements are in place.

Conclusions

109 The Panel is concerned that a critical aspect of a takeover, being the offeror's ability to meet its payment obligations, is not addressed directly in the Code.

110 The Panel is conscious of the risks to the integrity of the takeovers market that could be caused by a transaction not completing. This risk can be mitigated with disclosure of funding arrangements to better allow shareholders to assess the degree of counterparty/completion risk and with restrictions to disincentivise and protect against an offeror making a takeover offer with insufficient certainty that it would be able to comply with its obligations.

111 The current position in New Zealand provides limited protection to shareholders and is out of step with international practice. While the Panel has a preference for reform, it considers that there are legitimate options open and wishes to seek the views of market participants. The Panel's views are discussed below.

112 Importantly though, the Panel considers that the UK approach is not a practical option for New Zealand. In the first instance, the UK approach depends on having a large number of well-resourced investment banks which are able to provide cash confirmations. More generally, the Panel considers that the UK approach would represent a significant departure from current New Zealand law.

113 Accordingly, while the UK approach has been provided for context and information, the Panel has decided not to include the UK approach as part of the options for consideration below.

114 The Panel notes that the UK disclosure requirements outlined above provide a more extensive level of disclosure than both the New Zealand and Australian regimes. As such, the Panel has included a question specific to these disclosure requirements below.

Options for reform

Summary of options

115 The following options have been identified:

(a) Option 1 maintains the status quo.

(b) Option 2 is analogous to the Australian approach. The Code would be amended to:

(i) place a direct obligation on the offeror to have sufficient committed debt and equity funding in place to meet its commitments under the offer and in respect of any liabilities incurred in respect of the offer; and

(ii) require specific disclosures regarding the funding.

116 The Panel currently has a preference towards Option 2, but wishes to consider the views of market participants.

Option 1: maintain status quo

117 Given that failure to pay consideration in a Code-regulated transaction is rare, the status quo may be adequate.

118 In considering how Option 1 meets the objectives for the Code, Option 1 does not encourage the efficient allocation of resources as it does not adequately address (or ensure the disclosure of) counterparty risk and does not promote the international competitiveness of New Zealand's capital markets as it is significantly out of step with international practice.

Option 2: Australian approach

119 The advantage of Option 2 is that it would provide shareholders with more assurance that the cash to pay the consideration offered will in fact be available.

120 The disadvantages of Option 2 are that it may create additional complexity and cost for an offeror wishing to make an offer.

121 In considering how Option 2 meets the objectives for the Code, Option 2 encourages, to a moderate extent, the efficient allocation of resources by promoting takeovers. Option 2 also promotes the international competitiveness of New Zealand's capital markets.

Questions: Financing of offers	
Number	**Question**
5.1	Is Option 1 or Option 2 your preferred option? Please give reasons. In particular, please state your preference for Option 1 or Option 2 and explain why.
5.2	What problems or benefits are there with either Option 1 or Option 2 that are not identified in this paper or in your other responses?
5.3	What disclosure requirements do you consider would be appropriate in a New Zealand context?

Section Two: Lower Policy Content Amendments

Part 7 of the Code – Unclaimed monies

Problem identification

122 Rule 61 of the Code outlines what steps must be taken if a minority shareholder, whose shares are subject to compulsory acquisition under the Code, does not return an instrument of transfer and also does not claim their consideration following the compulsory acquisition process (an **Outstanding Shareholder**).

123 Rule 61 states:

> *(1) If an outstanding security holder does not return to the dominant owner the documents referred to in rule 59, then, in the case of a compulsory sale, the dominant owner must, within 5 working days after the expiry of the 15-working-day period referred to in rule 59,—*
>
> *(a) deal with in accordance with subclause (2) or (3) (whichever applies)—*
>
> *(i) the consideration specified in the acquisition notice; or*
>
> *(ii) if rule 56A applies, the consideration that is payable under the rule; and*
>
> *(b) send to the code company an instrument of transfer for the outstanding securities, executed on behalf of the outstanding security holder by the dominant owner or its agent.*
>
> *(2) If the consideration is, or includes, cash, the dominant owner must pay the cash to the code company, which must—*
>
> *(a) deposit it in an interest-bearing trust account with a registered bank; and*
>
> *(b) hold it in trust for the outstanding security holder until it is claimed.*

124 Importantly, there is no limit on the time for which the money must be held in trust. Accordingly, the effect of rule 61(2) is that a dominant owner (most commonly an offeror following a successful full takeover) must transfer any unclaimed cash consideration to the Code company, which in turn must deposit the cash consideration into an interest-bearing trust account and hold it in perpetuity until the Outstanding Shareholder claims the money (the **Unclaimed Monies Requirement**).

125 The only limit on the Unclaimed Monies Requirement is the operation of the Unclaimed Money Act. The Unclaimed Money Act governs the administration of money held by an entity that cannot be attributed to an owner after a certain period has passed. Additionally, holders of unclaimed money are required to maintain a physical register that contains the details of unclaimed money arising over the previous year and to make this register available for inspection.

126 Under the Unclaimed Money Act, Code companies are permitted to transfer the unclaimed consideration to Inland Revenue after six years (or six months if the company ceases trading), avoiding the need to hold that money until the Outstanding Shareholder claims the money.[6]

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[6] The Panel is aware that Inland Revenue undertook a consultation process (which closed on 28 February 2020) in relation to proposed changes to the Unclaimed Money Act that would remove the need for holders of unclaimed money to maintain physical registers, reduce the period of time that must elapse before money is deemed unclaimed and improve Inland Revenue's ability to match unclaimed money with people.

127 The Panel understands that the Unclaimed Monies Requirement and difficulties with the Unclaimed Money Act have caused several issues.

Issues identified by the market

128 The Panel has received feedback from market participants that:

(a) the Unclaimed Money Act procedure is difficult to follow;

(b) the Unclaimed Monies Requirement is impractical, with money needing to be kept in trust for longer than is reasonably necessary, creating administrative difficulties; and

(c) the Unclaimed Monies Requirement is out of step with analogous market practices relating to schemes of arrangement and unclaimed dividend payments.

129 Each of these points are discussed below.

Difficulties following the Unclaimed Money Act process

130 The Panel has received feedback that the process for dealing with unclaimed money under the Unclaimed Money Act can be costly and time-consuming.

131 According to some market participants, the administrative costs of holding unclaimed money can, in some cases, be more than the value of the unclaimed money itself.

132 Additionally, some market participants have noted that the process of transferring unclaimed monies to Inland Revenue can be time-consuming, as can the requirement to keep a physical register.

Misalignment with market practice regarding schemes of arrangement

133 The process for dealing with unclaimed consideration is different from established market practice under a scheme of arrangement. The process for a scheme of arrangement is commonly determined by the terms of the Scheme Implementation Agreement (**SIA**).

134 The Panel understands that:

(a) SIAs commonly provide that the offeror must, by no later than the day before implementation of the scheme, deposit the total consideration to be paid into a trust account operated by the share registrar. The consideration is paid to shareholders upon transfer of the shares acquired under the scheme.

(b) Any electronic transfers to shareholders will be made on settlement, but where cheques are provided, they may go unclaimed. Further, it is possible that a shareholder's nominated bank account may have closed, and payment cannot be made for that reason.

(c) There will be a 12-month period during which the funds are held in trust and cheques may be cashed.

(d) After the expiry of the 12-month period, the target company will be permitted to use any unclaimed cash consideration for its benefit. At this point, any outstanding cheques may be cancelled.

135 Even though the target company has cancelled the cheques and can effectively use the outstanding consideration, the Outstanding Shareholder will continue to have a claim against the target company as an unsecured creditor.

Misalignment with market practice for unclaimed dividends

136 The market practice for dealing with unclaimed scheme consideration is similar to that for dealing with unclaimed dividends.

137 It is relatively standard for listed companies' constitutions to provide that all unclaimed dividends that remain unclaimed for at least 12 months after having been declared may be used for the benefit of the company until claimed and that the company is entitled to mingle the amounts of any unclaimed dividends with other money owned by the company. The company is not typically required to hold the unclaimed cash dividend in a trust account on behalf of the shareholder.

<u>Need for an Unclaimed Monies Requirement</u>

138 Despite the issues identified above, the Panel considers that some mechanism for dealing with unclaimed monies is necessary.

139 Some shareholders may not have updated their contact or banking details and it is likely that there will be some "gone no address" shareholders. However, the Panel is of the view that simply because a shareholder has not updated their address or otherwise does not claim payment, the shareholder should not have their property (i.e., securities in Code companies) compulsorily acquired without an ability to obtain the consideration.

140 Accordingly, the Panel considers that any revised version of Part 7 of the Code needs to ensure that:

(a) unclaimed funds are held in trust for an appropriate period of time; and

(b) if unclaimed funds are released from trust, shareholders should still be able to make a claim against a relevant company for those funds.

<u>Panel seeks feedback on this issue</u>

141 The Panel would like to hear the views of a broader range of market participants before deciding on a preferred option for reform (whether to amend the Code or maintain the status quo), as the extent of the unclaimed money issue is unclear at this stage.

142 Accordingly, the Panel will not make a recommendation on this issue until it has received and considered the views of market participants.

<u>Options</u>

Summary of options

143 The following options have been identified:

(a) Option 1 maintains the status quo.

(b) Option 2 would amend rule 61 of the Code as follows:

(i) Dominant owners would be required to transfer the unclaimed cash consideration to the Code company to be held on trust on behalf of the Outstanding Shareholders.

(ii) The cash consideration would need to be held for a period of 12 months. After the expiry of this period, the target company will be permitted to use the unclaimed cash consideration for the benefit of the target company and to mingle those funds with its other funds.

(iii) The Outstanding Shareholder will retain a claim against the target company (as an unsecured creditor).

Option 1: maintain status quo

144 The advantage of maintaining the status quo is that shareholders will have the certainty that, following a compulsory acquisition process, any unclaimed consideration will be held in trust until it is claimed.

145 The disadvantage of maintaining the status quo is that Code companies must continue to hold cash consideration on trust in accordance with the Unclaimed Monies Requirement, the costs of which (both administrative and actual) can outweigh the value of the unclaimed cash consideration itself.

146 In considering how Option 1 meets the objectives of the Code, the Panel thinks that Option 1 does not encourage the efficient allocation of resources. Nor does it maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Option 2: amend the Code so that Code companies may use unclaimed cash consideration after a 12-month period

147 The advantage of Option 2 is that the Unclaimed Monies Requirement will be aligned with the schemes process as well as with the way listed companies deal with unclaimed dividends. This would lessen some of the administrative costs without adversely affecting (in a material way) the protections afforded to Outstanding Shareholders.

148 The disadvantage of Option 2 is that it might adversely affect an Outstanding Shareholder where the target company becomes insolvent, and the Outstanding Shareholders become unsecured creditors at risk of recovering less than the full amount owed to them.

149 In considering how Option 2 meets the objectives of the Code, the Panel thinks that Option 2 encourages the efficient allocation of resources and helps maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Questions: Part 7 of the Code	
Number	**Question**
6.1	What other problems and/or benefits are there with either Option 1 or Option 2 that are not identified in this paper or in your other responses?
6.2	Do you agree with the 12-month period in Option 2? If not, what period do you consider appropriate?
6.3	Should shareholders have any preference over unsecured creditors in respect of unclaimed compulsory acquisition consideration after expiry of the 12-month period?
6.4	To your knowledge, how many claims are made on unclaimed compulsory acquisition consideration once it has been transferred to the Code company? In what period are such claims normally made?
6.5	Is Option 1 or Option 2 your preferred option? Please give reasons.

Derivative disclosures

Problem identification

150 Schedules 1 and 2 to the Code require (among other things) the disclosure of certain derivative interests:

(a) Clauses 7A and 7B of Schedule 1 require an offeror to disclose its own, its associates', and any substantial product holders' derivative interests in the target company.

(b) Clauses 6A and 6B of Schedule 2 require (among other things) a target company to disclose the derivate interests of its directors and senior managers (and their associates), as well as those of any substantial product holders.

151 The Panel considers that:

(a) the most relevant disclosure of derivative interests in the context of a takeover is that provided for under the FMCA, such that market participants can become aware when a person has obtained a derivative interest in a listed company prior to the issuance of a takeover notice (repetition of these disclosures in the context of a disclosure document after a transaction has become public is generally less relevant);

(b) complying with the derivative disclosure requirements can be problematic in the case of substantial product holders, as parties are dependent on the disclosures made in substantial product holder notices;

(c) the derivative disclosure requirements tend to not provide an indication of the precise exposure of the parties to the derivative instrument, reducing their efficacy; and

(d) notwithstanding the issues set out above, the disclosures are very time-consuming to prepare (suggesting that the disclosures may not be an efficient use of resources).

Options

Summary of options

152 The following options have been identified for addressing the problem:

(a) Option 1 maintains the status quo.

(b) Option 2 amends Schedules 1 and 2 to the Code to remove the requirement to disclose derivative interests of substantial product holders. Accordingly:

(i) offerors would only be required to disclose the derivative interests of the offeror and its associates; and

(ii) target companies would only be required to disclose derivative interests of directors and senior managers.

Option 1: maintain status quo

153 The advantage of maintaining the status quo is that the derivative disclosures may provide more information to shareholders (although this information may have varying degrees of usefulness).

154 The disadvantage of maintaining the status quo is that the issues with the derivative disclosures described above will remain.

155 In considering how Option 1 meets the objectives for the Code, the Panel thinks that Option 1 does not encourage the efficient allocation of resources. Nor does it maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Option 2: amend Schedules 1 and 2 to the Code to remove the derivative disclosure requirements in relation to substantial product holders

156 The Panel considers that this option would remove the least beneficial and most difficult of the derivative disclosures. While the Panel considered removing further disclosures, the Panel thinks that it is still important for shareholders to understand the position of the offeror and its associates as well as that of the target's directors and senior managers (and their associates). Such disclosures may provide valuable information on the incentives / existing interests of relevant people.

157 The Panel does not see any material disadvantage of this option – the disclosures in relation to substantial product holders are time-consuming to collate and may not provide much valuable information. The most valuable information is generally provided through the substantial product holder regime, which allows the market to understand how people may be looking to acquire an interest in a company in the future through derivatives.

158 In considering how Option 2 meets the objectives for the Code, the Panel thinks that Option 2 encourages the efficient allocation of resources and helps maintain a proper relation between the costs of compliance with the Code and the benefits resulting from it.

Questions: Derivative disclosures	
Number	**Question**
7.1	Is Option 1 or Option 2 your preferred option? Please give reasons.
7.2	What other problems and/or benefits are there with Option 1 and Option 2 that are not identified in this paper?

Amendments to the Personal Property Securities Act 1999 (PPSA)

Problem identification

159 There is a lack of clarity as to whether shares acquired under:

(a) a scheme; or

(b) compulsory acquisition under Part 7 of the Code,

are transferred to the offeror free from any existing security interests.

160 The Panel understands that these issues are often raised with offerors when they are seeking debt finance for acquisitions.

161 The Panel notes that this uncertainty is not applicable to shares acquired under a takeover offer (as distinct from compulsory acquisitions following a takeover offer).

The relevant definitions of the PPSA

162 Section 97 of the PPSA states that the interest of a purchaser of an investment security has priority over a perfected security interest in the investment security (which includes shares in a listed company) if the purchaser:

(a) gave value for the investment security;

(b) acquired the investment security without knowledge of the security interest; and

(c) took possession of the investment security.

163 The PPSA defines "purchase" as taking by sale, lease, discount, assignment, negotiation, mortgage, pledge, lien, issue, reissue, gift, or any other consensual transaction that creates an interest in personal property (including investment securities).

How the definitions conflict with the scheme regime and compulsory acquisition

164 The definition of "purchase" arguably does not include shares transferred in accordance with a scheme or shares compulsorily acquired under Part 7 of the Code, because in both cases those shares may be acquired without the consent of the shareholder who originally held those shares:

(a) In a case of a scheme, a shareholder may vote against the scheme resolution (or not vote at all), and still have their shares acquired if the scheme resolution is passed by the appropriate majority.

(b) In the case of compulsory acquisition under Part 7 the Code, a shareholder may have declined to accept a takeover offer, but nonetheless be compelled to sell their shares under compulsory acquisition – in a literal sense the compulsory acquisition process is not a "consensual transaction".

165 In summary, it is possible that under a scheme or compulsory acquisition process, no transaction has taken place that meets one of the methods of purchase provided in the definition of that term under the PPSA. Accordingly, it is not clear that the protections in section 97 apply.

166 The Panel understands that this issue can create difficulties in securing bank finance for acquisitions. The Panel also understands that this issue is more acutely felt in the case of schemes, as in a takeover it only arises

once compulsory acquisition has commenced and the offeror has obtained clear title to 90% or more of the shares in the Code company.

167 The Panel understands that this issue is addressed in part by, for example, including orders for transfer of clear title in final scheme orders.

Suggested resolution of problem

168 The Panel's suggested resolution to this problem is to recommend that the PPSA be amended to ensure that investment securities acquired by way of a scheme under section 236A of the Companies Act 1993 and the compulsory acquisition process under the Code will be free from existing security interests, absent knowledge of a security interest.

169 The Panel considers this solution to be appropriate because, if the status quo is maintained, the uncertainty around existing security interests for shares acquired by way of scheme or compulsory acquisition will continue to exist.

170 The advantage to this solution is that if the PPSA is amended, this would provide clarity that shares acquired by way of a scheme or compulsory acquisition will be free from existing security interests (subject to the absence of knowledge of those security interests). For example, the PPSA could be amended so that acquisition under a scheme of arrangement or compulsory acquisition under the Code falls under the definition of "purchase".

171 A further advantage of this solution is that it should remove the conflict between the definitions under the PPSA and the scheme and compulsory acquisition processes. The ability to take shares free of third-party interests is critical to the ability to effectively acquire a target company and maintaining a security interest in target shares is not compatible with a functioning takeovers market.

172 In considering how the Panel's proposal meets the objectives of the Code, this proposal encourages the efficient allocation of resources by promoting takeovers and promotes the international competitiveness of New Zealand's capital markets.[7]

Questions: Amendments to PPSA	
Number	**Question**
8.1	Do you agree with the suggested solution?
8.2	What other problems and/or benefits are there with the suggested solution that are not identified in this paper?

[7] The Panel understands that this position is clear under Australian law. As such, amending the PPSA in this manner would seem to harmonise New Zealand and Australian law.

Rule 47(4) of the Code

Problem identification

173 Rule 47 of the Code requires that certain documents must be sent to the Panel (or may be required by the Panel) during a takeover.

174 Rule 47(4) states:

> *An offeror or target company or person acting on behalf of any of them who, in relation to an offer or a takeover notice, publishes or sends to any offeree any statement or information that is not required to be published or sent by the rules of this code must, at the same time that the statement or information is published or sent, also send a copy of it to the Panel.*

175 The Panel has identified several issues with rule 47(4):

(a) a lack of clarity as to the application of rule 47(4) to call scripts, shareholder presentations and similar documents;

(b) a lack of clarity as to whether rule 47(4) applies to communications with individual shareholders; and

(c) a lack of ability for one party to a takeover to review and respond to the other's call scripts.

Issue 1 – clarification that rule 47(4) applies to call scripts, shareholder presentations and similar documents

176 The Panel has received feedback that the application of rule 47(4) is unclear as it relates to call scripts, shareholder presentations and similar documents.

177 The Panel initially responded to this by publishing an article in *CodeWord 44* clarifying that call scripts, shareholder presentations and slides, and other similar documents or information must be sent to the Panel. This was based on the Panel's view that the term 'published' should be construed widely, and includes information conveyed to shareholders at investor meetings or by telephone. Notably, the common feature of the documents that are to be provided to the Panel under this guidance is that they are communications to all shareholders or to larger groups of shareholders.

178 However, despite the Panel's guidance, there may be benefit in this position being expressly recorded in the Code to avoid any ambiguity or debate.

Issue 2 – clarification that rule 47(4) does not apply to communications with individual shareholders

179 There is a lack of clarity as to how rule 47(4) applies to communications to individual shareholders or small groups of shareholders. For example, the Panel understands that it is relatively common for offerors and targets to privately engage with major shareholders.

180 It is not clear if rule 47(4) requires disclosure to the Panel of, say, correspondence between an individual shareholder and the board about a question regarding the offer or negotiations relating to an intra-bid lock-up agreement. Market practice is that this information is not normally provided to the Panel.

181 The Panel considers that, although it does not wish to be copied on all communication with individual shareholders, the Panel should be able to request copies of that communication. The Panel considers that this is appropriate given the Panel's general supervisory role.

Issue 3 – offeror's ability to access the target's call script (and vice versa)

182 The Panel considers that the offeror and target should each be able to see the communications of the other party to all, or groups of, target company shareholders. This may currently occur in "friendly" takeovers, but not in hostile situations. The Panel is concerned that current practice may have adverse effects:

(a) Targets will not necessarily know what offerors say to shareholders via telephone campaigns (and vice versa). This affects each party's ability to effectively respond to the other's statements.

(b) Review by the other party helps protect against misleading and deceptive conduct.

183 Offerors and targets in hostile situations invariably oppose the release of their call scripts to the other party. Further, the companies who run calling campaigns generally do not want their call scripts disclosed publicly as they consider that they have intellectual property in the structure of the call script. Accordingly, in the past the Panel has not released the copies of call scripts that it has received despite receiving requests to do so.

184 While the Panel expects that this issue arises most commonly in relation to call scripts, the Panel considers that the same approach should apply to any shareholder presentations or other similar documents that are provided to a wider group of shareholders but are not otherwise publicly disclosed.

Options

Summary of options

185 The following options have been identified:

(a) Option 1 maintains the status quo.

(b) Option 2 amends / supplements rule 47(4):

(i) to clarify that communications that are only to one shareholder (or a small group of shareholders) will not be required to be provided to the Panel unless requested by the Panel;

(ii) to require that, in respect of call scripts, a final version of the call script is provided to:

(A) the Panel; and

(B) the other party (i.e., the offeror or the target, as applicable).

Option 1: maintain status quo

186 The advantage of maintaining the status quo is that rule 47(4) will continue to capture a very wide range of communications, which may provide some benefit to the Panel's oversight.

187 The disadvantages of maintaining the status quo are that the issues identified above will continue to exist.

Option 2: amend rule 47(4)

188 The advantage of Option 2 is that rule 47(4) will be more specific in what communication / information must be provided to the Panel. Additionally, the lack of clarity regarding the treatment of call scripts will be removed. Further, there will be more transparency with the messaging that parties are engaging in during a hostile / adversarial transaction.

189 The Panel acknowledges that a disadvantage is that a requirement to release call scripts may need to allow the release to be made on a confidential basis to protect the intellectual property of the parties running the calling campaigns.

Questions: Rule 47(4) of the Code	
Number	**Question**
10.1	Is Option 1 or 2 your preferred option? Please give reasons.
10.2	What problems or benefits are there with Option 1 and Option 2 that are not identified in this paper?