NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION TO THE TAKEOVERS PANEL ON THE JUNE 2000 DRAFT TAKEOVERS CODE

JULY 2000

SUBMISSION TO THE TAKEOVERS PANEL ON THE JUNE 2000 DRAFT TAKEOVERS CODE

Overview

1.1 This submission to the Takeovers Panel on the draft Takeovers Code is made by the New Zealand Business Roundtable (NZBR), an organisation comprising primarily chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 The NZBR has intensively researched the issue of takeovers regulation in the last 15 years. We have consulted many international experts in finance and economics. Many of them have come to New Zealand to contribute to the debate. We have made many submissions on this subject with which the Panel is familiar, and published other relevant papers.

1.3 The NZBR has consistently opposed regulations that require transfers of large parcels of shares to be accompanied by mandatory offers at the same price. There is minimal support for mandatory bid and equal price rules among reputable law and economics specialists. We see no reason to change our view. To the contrary, shareholders' votes on the listing options provided by the New Zealand Stock Exchange have only confirmed the judgment that such rules are normally not in the interests of shareholders and that most shareholders recognise this.

1.4 We remain opposed to the proposed Code. The Panel has provided no public policy rationale for depriving all shareholders of the ability to determine takeover provisions for themselves. If the government wishes to introduce a statutory Code, it should be based on the Stock Exchange's listing rules.

1.5 If the present Code is to be adopted we can see no conceivable argument for rule 5 which denies all companies the ability to opt out of its provisions. This rule should be deleted or substantially modified. The Swiss code provides one example of what might be done.

1.6 In the remainder of this submission we summarise our main reasons for opposing the proposed Code in principle. We see little point in responding more fully as the Panel has consistently shown itself to be unwilling to engage in principled analysis and debate and to have regard to the body of scholarship that has been placed before it. However, we have read a draft of the New Zealand Stock Exchange's more detailed response to the Panel and we support its thrust.

2. Discussion

2.1 The proposed Code will raise the transaction costs of obtaining and transferring large shareholdings. It is thereby likely to shelter incompetent management and weak boards from hostile takeovers. The reallocation of assets to higher valued uses will also be impeded. Takeover efforts will be discouraged, to the disadvantage of large and small shareholders alike. Since block shareholdings are common in New Zealand, the Code is likely to have a relatively large effect on the New Zealand market and lead to less efficient use of resources in the corporate sector. This will harm overall economic performance.

2.2 The proposed Code also deprives shareholders of the ability to choose their own rules for trading in each company's shares. Since it is clear that shareholders do not all think the same about these issues and company situations differ, this one-size-fits-all approach clearly prevents potentially large numbers of shareholders from obtaining their preferred arrangements.

2.3 The proposed legislation also changes property rights without compensation. Small and large shareholders bought their shares at a price that must, at the time, have fairly reflected the value of those shares *in their view*. Any subsequent change in their property rights may cause holders to experience windfall gains or losses. These gains and losses are unlikely to accord with conventional notions of equity. Furthermore, small shareholders can free-ride on the greater efforts that investors holding large blocks of shares typically put into monitoring a company's board and management. Regulation that reassigns property rights without compensation undermines the basis of democracy and prosperity.

2.4 Those who might be expected to benefit from the proposed Code include under-performing management teams and boards, investment bankers, lawyers, regulators and investor groups that hope to make a windfall gain from the proposed rearrangement of property rights. None of these gains would count as a benefit in any assessment of the costs and benefits of the proposed regulation to the nation as a whole. Policy experts routinely make the point that the views of those who stand to benefit from interventions should be given least weight in any assessment of their merits.

2.5 The Panel's failure to provide any sound public policy rationale for its proposals is frustrating. Some of the public agitation for an equal price rule is clearly driven by envy and greed. Some small shareholders would naturally like the rules to be changed in their favour – as they see it – as long as the costs fall on others. They appear to want to share in any premium on transfers of large parcels, but not in any discount. This is human nature, but it does not provide a sound basis for government regulation. Similarly, managers and boards that are destroying shareholder value will naturally want their tenure to be protected. Again this provides no sound public policy reason for governments to accede to their demands. Yet the Panel seems to feel no embarrassment in citing head counts in support of the regulations it proposes, as if this makes up for its failure to set out a principled analysis. What counts for sound public policy is not who is in support of or against a particular proposal, but the quality of their reasoning.

2.6 It is partly for these reasons that the NZBR has always relied heavily in its analysis of these issues on independent and eminent experts in public policy analysis from an economic and finance perspective. In our view those who disagree with expert analysis should be prepared to engage in professional debate and identify exactly where they believe alternative views are wrong. This is the only proper way to resolve disagreements.

2.7 Another strategy that the proponents of further regulation have all too often used to avoid debating the issue on its merits is to cite precedents from countries that have adopted mandatory codes. Yet the country with the largest securities market in the world, the United States, has no such legislation at the federal level other than in respect of tender offers (which account for a minority of takeovers). Governments can legislate for sound national interest reasons, or to satisfy politically important factional interests. Any number of governments have bad regulatory policies due to pressure from vested interests. Business lobbying for laws to protect incumbent management from hostile takeovers is such a standard phenomenon in markets like the United States that outside observers have expressed astonishment that the NZBR as an organisation of chief executives has opposed such regulation. In any case, circumstances can differ from country to country, as noted in respect of the pattern of large block shareholdings in New Zealand. There is no substitute for proper professional debate about the merits of alternative arrangements for New Zealand.

2.8 In respect of the Takeover Panel's current draft Code, we have no idea what public policy argument the Panel could make to deny a company's shareholders the right to determine their own takeover rules. While there might in theory be debate about what rule should apply when small and large shareholders are divided on any issue that could affect them differentially, in practice the voting on the New Zealand Stock Exchange's three takeover options has demonstrated that this problem has not been material. Shareholders have overwhelmingly endorsed options recommended by their boards. From a public policy perspective, we have no criticism of companies that that have chosen the more restrictive minority veto option. In principle there can be circumstances where such restrictions are in the best interests of the shareholders of a particular company, but they do not apply to companies at large. If the government wishes to introduce a statutory code, it should be based on the New Zealand Stock Exchange's listing rules which allow companies to recommend the option that suits their circumstances. The use of the Market Surveillance Panel to oversee a code would also avoid the expense and potential duplication of roles of a statutory panel.

2.9 At the very least, we can see no conceivable argument in support of rule 5 of the Code and consider that shareholders should have the right to opt out:

(i) prior to any initial public offering and therefore prior to any decision by small shareholders to buy into the company;[1] or

(ii) subsequent to a company's listing on the stock exchange, where a majority of each class of small and large shareholders votes to do so.

2.10 If the Panel really believes that its proposed rules would increase the value of company shares, it must explain why it is necessary to impose such rules on companies. Companies and stock exchanges have an obvious incentive to find the rules and arrangements that will minimise the cost to companies of raising equity capital. In our view the argument that a one-size-fits-all Code will lift share prices is so absurd that its use by the Panel or the government can only further undermine their credibility in the eyes of informed observers. If the government were serious about raising the level of share prices it would review the anti-business elements of its entire programme.

---

1 For example, an English version of article 22(2) of the Swiss Federal Act on Stock Exchanges and Security Trading states that "Companies may, prior to their equity securities being admitted to official listing on a stock exchange in accordance with paragraph 1, state in their articles of association that an offeror shall not be bound by the obligation to make a public offer pursuant to Articles 32 and 52." (The reference is http://www.copa.ch/texts/e/lbvm/lbvm.html.)