REGULATORY ALIGNMENT AND DEAL PROTECTION DEVICES

Recommendations to the Minister of Commerce and Consumer Affairs

July 2024

TAKEOVERS PANEL
TE PAE WHITIMANA

Contents

Contents	**2**
Glossary	**3**
Introduction	**5**
Background	5
Process and consultation	5
Approach of this paper	6
Recommendation	6
Regulatory Alignment	**7**
Application of rule 64 to schemes in relation to Code companies	7
Code rule requiring the provision of disclosure documents to the Panel	11
Code rule requiring Relevant Disclosures to be made in Scheme Booklets	13
Applying Code rules on disposals or acquisitions to Code company schemes	15
Application of committed financing and payment of consideration obligations to Code company schemes	18
The operation of the Panel's enforcement powers if Code rules are extended to Code company schemes	20
Deal protection devices	**27**
Regulation of deal protection devices	27

Glossary

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

2022 Recommendations	the Panel's Recommendations to the Minister of Commerce and Consumer Affairs – Amendments to the Takeovers Code and Related Legislation dated April 2022 (available at: https://www.takeovers.govt.nz/assets/LawReform/Recommendations/Recommendations-to-Minister-Technical-Amendments-April-2022.pdf)
Code	the Takeovers Code as set out in the schedule to the Takeovers Regulations
Code company	has the meaning set out in section 2A of the Takeovers Act
Code company scheme	a scheme that affects the voting rights of a Code company
Companies Act	the Companies Act 1993
Deal Protection Devices Consultation	the Panel's Deal Protection Devices Consultation Paper released to the market on 18 September 2023 (available at: https://www.takeovers.govt.nz/assets/LawReform/Consultations/Regulatory-Alignment-of-Schemes-and-Code-Offers-Consultation-Paper-18-September-2023.pdf)
Dual Regulatory Approach	has the meaning set out in paragraph 11(a)
FMA	the Financial Markets Authority
FMCA	the Financial Markets Conduct Act 2013
FMCA Fair Dealing Provisions	has the meaning set out in paragraph 9(b)
IAR	an independent adviser's report on the merits of a proposed transaction
Letter of Intention	a letter from the Panel stating the Panel's intention (on the then-available information and assuming voting thresholds are met) to issue a No-objection Statement, with such letter usually being provided prior to the initial Court hearing in respect of a scheme and in the form set out in Appendix C to the Schemes Guidance Note
Minister	the Minister of Commerce and Consumer Affairs
No-objection Statement	a statement from the Panel indicating that the Panel has no objection to a scheme under section 236A(2)(b)(ii) of the Companies Act
NZX Listing Rules	the NZX Listing Rules as provided by NZX at: https://www.nzx.com/regulation/nzx-rules-guidance/nzx-listing-rules
Panel	the New Zealand Takeovers Panel
Relevant Disclosures	has the meaning set out in paragraph 40

Regulatory Alignment Consultation	the Panel's Regulatory Alignment Consultation Paper released to the market on 18 September 2023 (available at: https://www.takeovers.govt.nz/assets/LawReform/Consultations/Regulatory-Alignment-of-Schemes-and-Code-Offers-Consultation-Paper-18-September-2023.pdf)
scheme	a scheme of arrangement under Part 15 of the Companies Act
Scheme Booklet	in respect of a scheme, the notice of meeting together with its explanatory memorandum or notes, the IAR and any other accompanying materials
Scheme Period	has the meaning set out in paragraph 58
Schemes Guidance Note	the Panel's Guidance Note on Schemes of Arrangement dated 1 November 2023
SIA	a scheme implementation agreement or other analogous agreement under which parties agree the terms of a scheme and how it will be implemented
Single Regulatory Approach	has the meaning set out in paragraph 11(b)
Takeovers Act	the Takeovers Act 1993
Takeovers Regulations	the Takeovers Regulations 2000

Introduction

Background

1 The Panel's functions include keeping under review the law relating to takeovers of Code companies and recommending to the Minister any changes to that law that the Panel considers necessary.

2 The Code came into force on 1 July 2001. The Panel has administered the Code since then and from time to time becomes aware, through its interaction with the market, of issues that leave the law relating to takeovers of Code companies less efficient and effective than it could be.

3 Many of the recommendations in this paper relate to amendments to the Code or the main body of the Takeovers Regulations and may be implemented by regulations made by way of an Order-in-Council. However, a number of the proposals also require amendments to the Takeovers Act, the Companies Act and the FMCA.

Process and consultation

4 The Panel's process of consideration and public consultation relating to these recommendations was as follows:

(a) During late 2022 and early 2023, the Panel considered whether law reform might be appropriate. Where the Panel considered that law reform was, or might be, appropriate, the Panel sought market feedback through a consultation process.

(b) The Panel published two consultation documents on 18 September 2023. These documents are available here: Regulatory Alignment Consultation and Deal Protection Devices Consultation.

(c) In addition to publicly announcing the consultations, the Panel sought submissions from key market participants in New Zealand which the Panel considered to be best positioned to comment on the proposals.

(d) The closing date for submissions was set as 1 December 2023. However, some extensions were granted to allow time for interested parties to complete their submissions.

(e) In total, 11 submissions were received across the two consultation documents. Six of those submissions were from major New Zealand corporate law firms. Submissions were also received from the Accident Compensation Corporation, Jarden, the New Zealand Corporate Governance Forum, the New Zealand Shareholders' Association and NZX Limited.

(f) The Panel considered the submissions at a meeting on 20 February 2024.

(g) Draft recommendations were considered and approved by the Panel on 4 June 2024.

Approach of this paper

5 This paper sets out the Panel's final recommendations following consideration of submissions. The Panel notes that the Parliamentary Counsel Office is the body responsible for drafting legislative amendments.

Recommendation

6 The Panel recommends to the Minister, under section 8(1)(a) of the Takeovers Act, the amendments to the Code, the Takeovers Act, the Companies Act and the FMCA proposed in this paper, together with any other consequential amendments to other legislation to effect those amendments.

Carl Blanchard
Chair
Takeovers Panel
3 July 2024

Regulatory Alignment

Application of rule 64 to schemes in relation to Code companies

The problem

7 Rule 64 of the Code prohibits misleading or deceptive conduct in relation to Code offers and other Code-regulated transactions. The Panel actively monitors compliance with rule 64 by the offeror, target, shareholders and any other person commenting on the transaction. The Panel's practice is to engage immediately with the relevant party when there may be a potential breach of rule 64. Where the relevant party does not or cannot resolve the potential non-compliance with rule 64, the Panel may exercise its enforcement powers under Part 3 of the Takeovers Act. The Panel's enforcement powers in respect of rule 64 commence in the preliminary stages of a Code regulated transaction, apply during the period of the transaction and continue even if misleading or deceptive conduct is identified after completion of a Code regulated transaction.

8 Rule 64 does not apply to schemes in respect of Code companies. This is because schemes are not a "transaction or event that is regulated by" the Code[1] and the Code does not apply where the Court has made final orders in relation to a scheme.[2]

9 Misleading or deceptive conduct is, however, regulated in relation to schemes in other ways:

(a) When the Panel considers whether to provide a letter of intention or No-objection Statement it will consider whether the disclosures provided to shareholders may be misleading or deceptive.

(b) Misleading or deceptive conduct is directly prohibited under Part 2 of the FMCA (the **FMCA Fair Dealing Provisions**). The FMCA Fair Dealing Provisions prohibit, amongst other matters:

(i) in trade, persons from engaging in conduct relating to financial products or services that is or may:

(A) be misleading or deceptive;[3]

(B) amount to an unsubstantiated representation;[4] and

(ii) persons from engaging in conduct that is misleading or deceptive or likely to mislead or deceive in relation to any dealing in quoted financial products.[5]

Any breach of the FMCA Fair Dealing Provisions may lead to civil liability.[6] Remedies include a declaration of contravention, a pecuniary penalty order, a compensatory order and/or a civil liability order.[7]

[1] Nor are schemes transactions or events "likely to be regulated by" the Code (see rule 64(2)).
[2] See section 236B of the Companies Act and section 23A of the Takeovers Act.
[3] Section 19(1) of the FMCA.
[4] Section 23.
[5] Section 19(2).
[6] See subpart 3 of Part 8 of the FMCA.
[7] See sections 486, 489, 494 and 497, respectively.

(c) The FMCA also prohibits the making of false or misleading statements or the dissemination of information that:[8]

(i) the person responsible knows or ought to know is false or materially misleading; and

(ii) is likely to have certain consequences, including inducing a person to exercise a voting right in a particular way.

(d) Further, the FMA may bring criminal charges against a person if the person knows the statement made or information disseminated was false in a material respect or was materially misleading.[9] If the FMA is satisfied that a person has contravened or is likely to contravene the FMCA Fair Dealing Provisions it may also make a direction order.[10]

10 Accordingly, misleading or deceptive conduct is regulated in both Code and scheme transaction structures. However, the Panel has considered whether the inconsistencies in the current approach are appropriate:

(a) *Lack of a rational basis for different regulation:* Ultimately, schemes and Code regulated transactions are alternative means of achieving the same outcome. The Panel considers that it is inefficient and potentially confusing for shareholders where the rules governing misleading or deceptive conduct apply a different standard in Code regulated transactions and schemes. Examples of the differences are:

(i) In a scheme context, for a statement to be subject to regulation under the FMCA Fair Dealing Provisions, it would have to be made by a person "in trade" where the target company is unlisted, whereas in a Code regulated transaction, all relevant statements are regulated by rule 64, regardless of whether they are made by a person "in trade" or not. The requirement for statements in respect of an unlisted target to be "in trade" to be subject to the FMCA can therefore exclude from regulation any public (or widely disseminated) statements made by shareholders on a scheme where those persons are not "in trade", even if such statements would be regulated in a Code regulated transaction.

(ii) In a scheme context, there is a restriction on unsubstantiated representations. The lack of a restriction on unsubstantiated representations in Code regulated transactions is an issue on which the Panel has recently consulted. The feedback received by the Panel led it to conclude that it would be preferable to retain the status quo and not amend the Code to include a restriction of this type. The rationale for not recommending a restriction on unsubstantiated statements included that:

(A) rule 64 addresses the key concern (misleading or deceptive conduct), whereas a restriction on unsubstantiated representations may create liability in respect of statements that were not misleading or deceptive;

(B) a restriction of this type could create difficulties with honest expressions of opinion, which are common and important in contested Code regulated transactions where opinions may differ;

(C) a restriction on unsubstantiated statements would increase the scope for disputes and create uncertainty around the required level of due diligence and verification (both of which are difficult in a time pressured transaction such as a Code regulated transaction); and

[8] Section 262.
[9] Section 264.
[10] Section 468.

(D) a restriction on unsubstantiated statements would increase compliance costs, which would not outweigh the uncertain benefits of a restriction.

(iii) The maximum pecuniary penalties differ – in a scheme context, a penalty can equal up to three times the amount of the gain made or loss avoided, whereas penalties in a Code regulated transaction are limited to a maximum sum of $5 million.

(b) *Lack of clarity as to which restriction applies and when:* Code regulated transactions and schemes are structures used to achieve a commercial outcome. If the transaction structure that an offeror will use is initially uncertain (or changes), this introduces uncertainty and complexity in relation to:

(i) the regulatory standards (and remedies) which apply; and

(ii) how potential breaching conduct should be addressed,

where the underlying transaction relates to the same commercial outcome. The issue would become more pronounced should a "dual track" offer be made in New Zealand (as has occurred in Australia). Dual track offers involve an offeror making a takeover offer and proposing a scheme at the same time.

(c) *Potential inefficiency and delays in addressing issues intra-transaction:* The Panel actively monitors schemes for potential misleading or deceptive conduct. The Panel is also familiar with the schemes process, giving it institutional knowledge and familiarity in relation to any issues that might arise during a transaction. While the FMA is a well-staffed organisation with deep knowledge of financial markets law and prosecutorial experience, FMA personnel would not be as familiar with the background facts of a live transaction as Panel staff would be. The Panel's role intra-transaction enables the prompt correction of misleading information where this is necessary to allow shareholders to decide on the merits of a proposed transaction. While the Panel and the FMA work closely under a memorandum of understanding, the logistics of referring a matter to the FMA may result in slower regulatory action than if no referral was required.

11 If rule 64 is applied to schemes, there is the further question of whether the FMCA Fair Dealing Provisions should continue to apply to schemes (i.e., there would be 'dual' regulation).[11] The Panel considered that there were two potential approaches:

(a) **Dual Regulatory Approach** – Under this approach, the FMCA would continue to apply to schemes *in addition to* rule 64. This approach would require amendments to the FMCA and the Takeovers Act to ensure that the two regimes did not inappropriately conflict, including, for example, amendments to ensure pecuniary penalties could not be imposed under both Acts for the same conduct and contradictory orders could not be made by the FMA and the Panel.

(b) **Single Regulatory Approach** – Under this approach, the FMCA would be amended so that the FMCA Fair Dealing Provisions do not apply where the Code applies.

Consultation submissions

12 A majority of submitters either considered that rule 64 should be applied to schemes or did not strongly oppose its application. A minority of submitters opposed the proposal on the basis that there had been no

[11] For clarity, if a scheme involves the offer of scrip consideration, Part 3 of the FMCA should apply to the offer of financial products (as it does where scrip consideration is offered in a Code offer).

issues requiring reform and/or that the introduction of rule 64 would interfere with the Court's role in schemes.

13 Several submitters were concerned that reform would reduce shareholder protections in schemes. These submitters were opposed to applying rule 64 to schemes on the basis that the restriction on unsubstantiated representations under the FMCA would be removed. On the other hand, these submitters also supported the introduction of a restriction on unsubstantiated representations for Code regulated transactions.

14 One submitter opposed applying an unsubstantiated representations restriction to either transaction structure.

15 Submitters were split on the question of the Single Regulatory Approach or Dual Regulatory Approach, though all favoured the Panel being the lead regulator for Code company schemes, particularly while a transaction was live.

16 One submitter (who opposed applying an unsubstantiated representation restriction) additionally suggested that rule 64 should be given more prominent status by being incorporated into the Takeovers Act rather than the Code.

Analysis and recommendations

17 The Panel recommends that a prohibition on misleading or deceptive conduct, in line with rule 64 of the Code, be applied to Code company schemes, with the Panel acting as the primary regulatory body (subject to overriding High Court jurisdiction in respect of schemes and the FMCA remaining responsible for criminal misleading and deceptive conduct, as described below).

18 Regarding unsubstantiated representations restrictions, the Panel recommends against applying a restriction of this type to Code-regulated transactions (as is currently the case) and recommends that the same approach be taken in relation to Code company schemes.

19 The Panel's reasons for its recommendations are that:

(a) Application of rule 64 to schemes would provide clarity and consistency in the regulation of misleading or deceptive conduct in change of control transactions, providing a uniform standard for the market.

(b) Reform would not create new or additional obligations on market participants and would not require material changes to the current schemes process.

(c) Reform would:

(i) assist in ensuring that the holders of financial products are provided with equivalent levels of protection in respect of the information provided under the Code and in a Code company scheme; and

(ii) maintain a proper relation between the costs of compliance with the Code and Code company schemes and the benefits resulting from them.

20 The Panel notes that some submitters were concerned that reform could create a conflict between the Panel's role and the Court's role. The Panel notes that this is already an issue because of the FMA's current jurisdiction. In the Panel's view, reform does not materially increase the risk of conflict with the Court because:

(a) The Panel's current ability to take enforcement action for breaches of rule 64 for Code regulated transactions is limited except with Court involvement.[12]

(b) The Court has limited ability to deal with misleading or deceptive conduct in a scheme. The Court process begins several months into the scheme process, once initial orders are sought.

(c) In response to misleading or deceptive conduct the Court can provide only 'negative' control (i.e., not approve a scheme), which may be of limited effect where the conduct in question hurts the chances of the scheme receiving shareholder approval.

21 However, out of a desire to be clear as to the Court's role, the Panel recommends that the Takeovers Act clarify the relationship between the Panel and the Court in relation to schemes of arrangement. The Panel considers that this should recognise the Court as the primary body which determines whether a Code-regulated scheme of arrangement should be given effect to and, where the Court has made orders in relation to a scheme, the Panel must not make orders or accept undertakings which would prevent compliance with those orders.

22 Regarding unsubstantiated representations, the Panel considers that, in the fast-changing environment of control-change transactions, a verification requirement would be inefficient and impractical.

Code rule requiring the provision of disclosure documents to the Panel

<u>The problem</u>

23 The Panel monitors transactions in real time. The Panel considers that such active monitoring is critical to allow issues to be addressed intra-transaction and avoid the difficulties of establishing appropriate remedies for deficient disclosure after completion of a transaction.

24 To facilitate the Panel's active monitoring of Code regulated transactions, rules 41 to 48 of the Code require:

(a) the offeror and target company to provide the Panel with relevant documents at the same time as they are provided to shareholders; and

(b) any person to provide the Panel with any statement or information relating to an offer that is published or sent to offerees by an offeror or target company, that may not already be required to be provided under the Code.

25 This allows the Panel to consider intervention in real time (rather than relying on complaints being made) and keeps the Panel apprised of the full public discourse so it can understand and address issues as they arise.

26 In a Code company scheme, the Panel's role is to assist the Court. Primarily, this is done through its consideration of whether or not to issue a No-objection Statement.

[12] For a description of the Panel's enforcement powers and their limitations under the Takeovers Act, see the section 'The operation of the Panel's enforcement powers when Code rules are extended to schemes' from paragraph 77 below.

27 The Panel considers disclosure to shareholders when it decides whether or not to issue a No-objection Statement. In this role, the Panel considers factors such as:

(a) whether all material information relating to the scheme has been disclosed to shareholders; and

(b) whether disclosure to shareholders is of the standard that would be required by the Code in a Code-regulated transaction (or is otherwise appropriate in the circumstances).

28 Accordingly, the Panel considers it important that it receives all relevant information in relation to a Code company scheme in order to have a full understanding of what has been provided to shareholders in the same way as it would in a Code regulated transaction.

29 The Companies Act requires a Code company in a scheme to give notice to the Panel of its application to the Court when it is filed. However, there are no other legal obligations to provide information to the Panel. For example:

(a) a Code company scheme applicant is not required to provide final copies of its Scheme Booklet or other shareholder communications to the Panel; and

(b) there is no requirement on third parties to provide the Panel with copies of communications to shareholders in relation to a Code company scheme.

30 This issue is more acute because the Panel is proposing to extend rule 64 to Code company schemes. The Panel would be the body responsible for regulating misleading or deceptive conduct during a Code company scheme but would have no direct regulatory jurisdiction to require that it receive key materials.

Consultation submissions

31 The majority of submitters agreed that there should be an obligation to provide scheme documents and information to the Panel and agreed with the proposed documents and information to be provided under the obligation.

32 Some submitters commented that the Panel already had enough leverage under the No-objection Statement process to be provided the relevant documents and information, and thus a statutory requirement was not needed.

33 Some submitters proposed requiring additional documents be provided to the Panel. For example, one submitter commented that the obligation should include voting agreements, standstill or pre-SIA signing deal protection arrangements that the target company was party to or had in its possession.

34 Another submitter (who opposed reform in this area) considered that if the obligation was introduced, ancillary documents such as call scripts should not be required, unless as part of a rule 64 investigation.

Analysis and recommendations

35 Although the Panel can request information through the No-objection Statement process, the provision of documents under this process is ultimately voluntary. This creates a risk that the Panel may not receive the necessary information to allow it to properly monitor a transaction. Further, if rule 64 is amended as proposed, it is appropriate for there to be an obligation to provide documents to the Panel.

36 The Panel recommends that there should be a requirement on parties to a scheme to provide all relevant transaction documents to the Panel, including the Scheme Booklet and any other communications to shareholders.

37 To this end, the Panel recommends that rule 47 of the Code be amended to require provision of the following documents/information to the Panel at the following times:

(a) any SIA and any related Code company scheme agreements, including any deed poll, standstill or deal protection device to which the target (or any of its directors) is a party or any voting agreement and any amendments to any of them – upon execution (these documents should be released publicly or made available to shareholders on signing of an SIA or issue of a takeover notice, as applicable); and

(b) other communications to shareholders (including the Scheme Booklet) – when sent.

Code rule requiring Relevant Disclosures to be made in Scheme Booklets

<u>The problem</u>

38 Disclosure is critical in both Code regulated transactions and Code company schemes in order to allow shareholders to be able to effectively decide the merits of a transaction for themselves.

Disclosure in a Code regulated transaction

39 In a Code regulated transaction, all required disclosures are set out in the Code. The Panel executive reviews these disclosures for compliance with the Code. This process, in conjunction with the enforcement provisions in the Takeovers Act, provides a way to enforce disclosure requirements and obtain remedies where appropriate.

40 The prescribed disclosure requirements in a Code offer can be summarised as follows:

(a) the obligations to provide a takeover notice, offer document, target company statement and associated notices under rules 41, 41A, 43 and 44 – 47 (analogous to the entry into a SIA and a Scheme Booklet);

(b) the obligation to give notice of any alterations or additions to the offer document under rule 28 (analogous to amendments to an SIA or other scheme document, or supplements to a Scheme Booklet);

(c) the disclosures required within a takeover notice, offer document and target company statement by Schedules 1 and 2 (broadly analogous to information set out in a Scheme Booklet); and

(d) the obligation to provide an IAR under rule 21 and, if applicable, a rule 22 report (analogous reports are generally provided in relation to Code company schemes, albeit that in the case of a Code company scheme, the same independent adviser will usually prepare both reports if both are required),

(together, the **Relevant Disclosures**).[13]

[13] The Panel has previously recommended amendments be made to disclosure rules in relation to funding for Code offers. Accordingly, the Relevant Disclosures include any amendments to the disclosures as a result of the 2022 Recommendations.

Disclosure in Code company schemes

41 Disclosures equivalent to Schedules 1 and 2 of the Code have, to date, been included in all Scheme Booklets for Code company schemes.[14] The Panel's guidance is that it expects "Code equivalent disclosure", or a satisfactory explanation as to why it is not necessary, before the Panel will provide a No-objection Statement. Where disclosures are incorrect, the FMCA Fair Dealing Provisions are likely to apply to such information, which, amongst other matters, may lead to civil liability (including pecuniary penalties) under Subpart 3 of Part 8 of the FMCA.[15]

42 However, after a Code company scheme completes, there is no direct consequence or remedy for any missing Code-equivalent disclosures. To explain further:

(a) If a Scheme Booklet does not contain relevant information, that may make the Scheme Booklet misleading and in breach of the FMCA Fair Dealing Provisions. However, to establish a breach under the FMCA Fair Dealing Provisions, it would also need to be shown that the document was (or was likely to be) misleading (rather than that it merely lacked certain disclosures). This type of further evidential hurdle can significantly complicate non-disclosure proceedings.

(b) It may be that the Panel could decline to issue a No-objection Statement unless a Scheme Booklet contains 'negative' disclosures – e.g., that except as disclosed, the offeror does not have any relevant interests in the target. However, refusal to provide a No-objection Statement is a blunt instrument and it may not always be appropriate to withhold one where there are disputes over disclosures.

(c) Although shareholders might have claims for negligent misstatement where a party to a transaction fails to make certain disclosures, this would be a novel claim. Further, there would be complex questions of causation and quantification of loss, complicating such proceedings.

(d) Although a claim of misleading the Court might be available where disclosure is not made or is inaccurate, such a claim would likely require an element of intention which could be difficult to establish.

<u>Consultation submissions</u>

43 Submitters were split on this topic:

(a) Those that favoured requiring the Relevant Disclosures considered that high regulatory standards should be applied to disclosures in Code company schemes and that the Panel's current enforcement powers in response to potential disclosure failures in Code company schemes were too limited.

(b) Submitters that did not favour requiring the Relevant Disclosures argued that such disclosures were already made, and most Code disclosures are not relevant to Code company schemes – as such, the need to obtain waivers would only increase transaction costs.

44 One submitter instead proposed a 'middle ground' approach of:

(a) not requiring the Relevant Disclosures; but

[14] There have been some limited exceptions, such as the omission of director certifications in a Code company scheme where it would have required a complicated delineation of what information the "offeror" directors were certifying and what information the "target" directors were certifying.
[15] The Panel notes that if, as suggested in this paper, rule 64 is applied to schemes, then similar remedies (albeit with different penalties) would apply under the Code and the Takeovers Act.

(b) imposing a 'completeness' requirement for Scheme Booklets along the lines of the NZX Listing Rules' requirement that notices of meetings of financial product holders "contain or be accompanied by sufficient explanation, reports, valuations, and other information, as to enable a reasonable person entitled to vote to understand the effect of each resolution proposed".[16]

Analysis and recommendations

45 In the Regulatory Alignment Consultation, the Panel proposed reform requiring the Relevant Disclosures in Code company schemes, excluding certain disclosures which would only apply to Code regulated transactions.[17] However, in light of the submissions, the Panel has since considered that the alternative 'completeness' requirement approach proposed by one of the submitters is most appropriate.

46 In the Panel's view, this strikes a good balance between having some recourse against poor disclosure which is only identified after the Code company scheme is approved, while also preserving the flexibility of Code company schemes. The key issue is making sure that missing disclosures are clearly covered – while rule 64 partially covers missing disclosures, it is imperfect relative to a 'completeness' standard.

47 In the Panel's view, the addition of a 'completeness' disclosure obligation would further address some of the concerns which led some submitters to advocate for greater protections and higher standards in respect of information provided to shareholders in Code company scheme documents.

48 Accordingly, the Panel recommends that all disclosure in relation to a Code company scheme be subject to an 'all other material information' requirement equivalent to the requirement under clause 24 of schedule 2 of the Code.

49 The Panel recommends that law reform should provide for a formulation of a 'completeness' standard (such as that along the lines of rule 7.8.1 of the NZX Listing Rules to be applied to both target company statements and Scheme Booklets. The Panel also recommends that this 'completeness' standard should apply to documents relating to Code-regulated acquisitions and disposals under rules 15 and 16 of the Code.

Applying Code rules on disposals or acquisitions to Code company schemes

The problem

Disposals and acquisitions in a Code regulated transaction

50 In Code regulated transactions, the Code restricts the offeror and its associates from selling or acquiring shares in a target during the offer period:

(a) *Dispositions:* Under rule 35, an offeror and its associates are prohibited from disposing of any securities in the target other than to the offeror or to another offeror making a separate offer under the Code.

(b) *Acquisitions:* Under rule 36, the offeror and its associates are prohibited from acquiring any securities in the target other than under the Code offer unless (among other requirements) notice is given and, where the offer remains conditional, the offeror does not acquire more than 20% of the voting rights in the target. Critically, under rule 37, if the consideration for the non-Code offer acquisition exceeds the Code offer consideration, the Code offer will be deemed to be increased to the amount of the non-Code offer acquisition.

[16] Rule 7.8.2 of the NZX Listing Rules.
[17] The Panel saw clauses 9(2) and 19 of schedule 1, and clauses 19A(2) and 26 of schedule 2, as falling into this category.

51 These rules support the Code's objectives of ensuring that all shareholders are treated fairly (by not receiving a preference over shareholders that accept the offer) and recognising that shareholders must ultimately decide for themselves the merits of a Code offer (by allowing shareholders to sell at less than the offer price should they wish). They also help to ensure that offerors acquire shares on the same terms and consideration offered to all shareholders. Finally, they prevent other mischief that might occur during a Code offer, such as an offeror selling down their shareholding to avoid meeting minimum acceptance conditions.

Disposals and acquisitions in a Code company scheme

52 An offeror in a Code company scheme might cause mischief analogous to that which can be caused in a Code offer by acquiring or disposing of shares before the shareholder vote.

53 For example, after the announcement of a scheme, the offeror and/or its associates may dispose of shares they hold in the target to a non-associate at a price lower than the scheme consideration. This might occur if the offeror is concerned that the main interest class may vote against a scheme resolution. By doing this, the offeror effectively "obtains" votes in the main interest class by selling shares on market (therefore anonymously) at a discount to the scheme consideration, knowing that the only likely purchasers are persons looking for an arbitrage opportunity to vote in favour of the Code company scheme. For a cost, the offer would therefore "shift" votes from the offeror's separate interest class to the main interest class, increasing the chance that the main interest class approves the resolution.

54 The Panel recognises that some visibility over this issue is provided by the general requirement that any shares traded between the announcement of the scheme and the date of the Scheme Booklet be disclosed in the Scheme Booklet. For any acquisition or disposal after the release of the Scheme Booklet, visibility may also be provided under the substantial product holder disclosures where the acquisition or disposal amounts to a substantial holding under the FMCA.[18] However, the Panel considers that while disclosure provides some exposure over these issues, it does not provide a complete solution. Specifically:

(a) Although information as to an offeror's shareholdings will be disclosed in a scheme booklet, these shareholdings might change before the vote. While some changes may have to be disclosed under the FMCA, this might not be the case – for example increases from 0% to 4.9% or where the target is unlisted. While these details might ultimately be required to be disclosed to the Court, the Panel considers that shareholders should be able to cast their votes with the knowledge of where the thresholds will sit in the particular case.

(b) Disclosure fails to address the underlying risk of an offeror and/or its associates manipulating a scheme vote in its favour.

55 At present, the Panel seeks to manage these issues in the following ways:

(a) In order to obtain a No-objection Statement, the Panel will require offerors to sign a deed poll, enforceable by the Panel, that commits the offeror to continue to hold their shares and to vote them in favour of the scheme.[19] However, there is no equivalent to the deed poll in the case of an offeror acquiring shares.

(b) Should acquisitions or dispositions of shares occur during a scheme which would not be permitted under a Code regulated transaction, the Panel may withhold a No-objection Statement or make submissions to the Court.

[18] 'Substantial holding' means a relevant interest in 5% of more of quoted voting products in a listed company, as set out in section 274(2) of the FMCA.
[19] This requirement is set out in the Schemes Guidance Note at paragraphs 5.11 – 5.12.

56 Additionally, oversight comes from disclosure of the offeror's shareholding in affidavits filed with Court. This should mean that any manipulation of the type described above will be considered by the Court in its consideration of the scheme. As such, tactics of this type risk the Court not sanctioning the Code company scheme. These issues would likely be particularly pronounced where the offeror's actual position was not disclosed in the Scheme Booklet, which (as discussed above) may occur where there is an acquisition of shares after the date of the Scheme Booklet or the target is unlisted.

57 However, the limitations of this current approach are that:

(a) Where changes occur late in a process, they will not be included in a Scheme Booklet and may not be adequately drawn to shareholders' attention (or, in some circumstances, disclosed at all prior to the vote).

(b) There is no direct legal restriction on acquisitions or dispositions during a Code company scheme. This could be problematic because:

(i) After a Code company scheme completes, there would be no clear remedy for this type of conduct. If the Panel discovers at a later stage that a disposal or acquisition did occur, such that there was a likely mischief at the shareholder vote, it would be difficult for the Panel to meaningfully address it.

(ii) The requirement for a deed poll could be avoided by a Code company scheme participant if they did not seek a No-objection Statement, albeit that the parties should be expected to draw any relevant matters to the Court's attention.

Consultation submissions

58 A majority of submitters agreed with applying Code rules on acquisitions and disposals to Code company schemes during the period from signing the SIA until completion of the Code company scheme or when the Code company scheme is terminated in accordance with its terms (the **Scheme Period**).

59 One of these submitters considered that there should be a waiver mechanism where the nature of the Code company scheme is not one in which the disposal or acquisition could be considered to have a potentially mischievous outcome or intent.

60 Submitters that did not agree with the Panel's proposal considered that actions of this type did not have mischievous potential or could be dealt with through the composition of interest classes or the Court process.

61 The Panel does not agree with the analysis for arguments against this reform. The Panel has had direct feedback that these are live issues. The Panel considers that imposing a regulatory requirement will simplify the supervision process.

Analysis and recommendations

62 The Panel recommends that there be a prohibition on acquisitions and disposals of Code company shares during the Scheme Period. The Panel considers that this would formalise the Panel's current policy position; the Panel already requires offerors to sign a deed poll enforceable by the Panel restricting dispositions and has issued guidance on dealings during a Code company scheme.

63 The Panel further recommends adding a waiver mechanism to these requirements and recommends that such a mechanism also apply in the case of a Code regulated transaction along the lines of the ability of the Panel under rule 39 to permit actions in a Code offer that would otherwise be considered defensive tactics.

Application of committed financing and payment of consideration obligations to Code company schemes

The problem

64 It is rare for offerors in a Code company scheme or takeover to have the necessary cash consideration immediately available upon launching an offer. Further, offerors are likely to obtain their financing from a variety of different sources (e.g., a mix of debt and equity, or a call of committed funds from a related party).

65 However, it is important that offerors can complete transactions in accordance with their terms. A failure to make payment would undermine confidence in the market. Regulatory settings should minimise (as far as practicable) the prospect of a transaction failing to settle because of lack of financing. To the extent there is finance risk, this should be disclosed so that shareholders can assess it. However, the Panel considers that disclosure alone is not always sufficient to mitigate these issues. Further, offerors are ultimately best placed to manage this risk, and should be incentivised to minimise it.

66 While the Code currently provides some protection in the context of Code regulated transactions through a required statement about the offeror's financing,[20] the Panel proposed enhancing these protections in the 2022 Recommendations by amending the Code to:

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

(b) require specific disclosures regarding the offeror's funding arrangements; and

(c) require payment of consideration when due.

67 In effect, the same issues arise in the case of Code company schemes. There is no express regulatory requirement for an acquirer to:

(a) have the resources available to pay the consideration (or other related amounts);

(b) disclose the acquirer's financing arrangements (and even if disclosure is made in a Scheme Booklet it will be made some time after the transaction has been announced so that the risk of financing issues arising has already commenced); or

(c) make payment when due.

68 There are some ways in which this issue may currently be addressed in Code company schemes:

(a) Due to the negotiated nature of schemes, the target board can assess the creditworthiness of the offeror and, to the extent there are concerns, seek mitigating obligations. However, market practice varies and not all target boards seek (or have the negotiating leverage to demand) the same assurances.

(b) Code company schemes generally settle on all shareholders at once via a centralised payment which is held in escrow until payment is made to all shareholders simultaneously. Therefore, non-payment would likely prevent completion. In contrast, a Code offer may settle in stages, and it might be possible for early acceptors to be paid while later acceptors are not.

[20] Under clause 9 of Schedule 1 to the Code, the offeror must provide confirmation 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".

(c) There is a requirement for an offeror to enter into a deed poll enforceable by the Panel where the offeror undertakes in favour of each shareholder, to deposit the consideration payable to all shareholders when due.

(d) Due to the Court approved nature of schemes, the Court may make an order requiring the offeror to make payment of consideration if it fails to do so.

(e) At a commercial level, if a purchaser failed to make payment it would be expected that they would struggle to agree any deals in the future (albeit that this would not resolve the issue with the scheme where payment was not made).

69 However, the Panel considers that despite these mitigating considerations, a failure to make payment on completion of a Code company scheme would be a significant issue and taking reasonable steps to protect against this possibility would be positive for market integrity.

70 In addition, if the Code is amended as proposed in the 2022 Recommendations, an offeror would be required to have committed funding and make payment in relation to Code regulated transactions but not under a Code company scheme. The Panel does not consider that Code company schemes and Code regulated transactions are sufficiently different to merit a difference in treatment of this type.

71 In the Regulatory Alignment Paper, the Panel proposed that the same funding obligations that apply in Code regulated transactions, including as the Panel proposed to amend them in the 2022 Recommendations, should be applied to Code company schemes. Essentially this would involve imposing:

(a) a direct obligation on the offeror to have sufficient committed funding in place to meet its commitments under the SIA and in respect of any liabilities incurred in respect of the Code company scheme;

(b) specific disclosures regarding the offeror's funding arrangements; and

(c) payment of consideration when due.

Consultation submissions

72 Most submitters agreed with the Panel's proposed approach set out above.

73 The submitters who did not favour reform were largely of the view that there were inherently more safeguards in a Code company scheme such that the issue was not as acute as in a Code regulated transaction. One of these submitters did, however, consider that it would be sensible to require an acquirer in a Code company scheme to disclose its financing arrangements in a similar fashion to that which applies in the context of a Code regulated transaction, including any conditions to which that financing is subject.

Analysis and recommendations

74 The Panel recommends that the funding and payment obligations set out in the 2022 Recommendations also be applied to Code company schemes, as outlined at paragraph 71 above.

75 Specifically, the Panel recommends:

(a) amending the proposed new rule 34A of the Code (as set out in the 2022 Recommendations) to apply to Code company schemes, so that offerors would be required to have the resources available to pay the consideration to be provided under the Code company scheme; and

(b) imposing an obligation to make payment when due under a Code company scheme.

76 As to disclosure, the Panel does not recommend requiring that the new disclosure requirements under the 2022 Recommendations set out at 5.15 (being proposed amendments to clause 9 of schedule 1 to the Code) apply to Code company schemes. The Panel would address this disclosure in a Code company scheme as part of the current No-objection Statement process.

The operation of the Panel's enforcement powers if Code rules are extended to Code company schemes

The problem

77 If one or more Code rules are applied to Code company schemes, the Panel's enforcement powers should be adapted appropriately to accommodate for these changes. The Panel considers that this should be done so that:

(a) The enforcement mechanisms available in respect of Code company schemes mirror those under the Code, to the extent possible. A key aim of the Panel's review of schemes regulation was to consider how best to promote the alignment of the policy underlying the regulation of Code offers and Code company schemes. Consistent with this objective, the enforcement of any rules should, to the extent possible, operate in a similar way. This helps ensure regulatory consistency and builds on existing practices which are well understood by the market and on precedents which the Panel has developed over the course of its operations.

(b) However, any Panel enforcement of Code rules in respect of Code company schemes should not cut across the Court's jurisdiction and ultimate discretion as to whether to approve a scheme. The Panel's role should continue to be complementary to the Court process, rather than in conflict with it.

78 To achieve the objective of aligning enforcement, the Panel considers that any enforcement powers in relation to Code rules that are applied to Code company schemes should be based on the Panel's current enforcement powers under the Takeovers Act. These powers are generally temporary in nature, with Court involvement and orders typically being required if any more permanent orders are sought.

79 Helpfully, the current broad enforcement scheme of the Takeovers Act is well suited to being applied to Code company schemes. At a high level, the Panel is able to investigate issues and preserve the status quo, but Court orders are required where a permanent solution is sought.

80 An additional feature of Panel enforcement processes for Code company schemes would be ensuring that any order made by the Panel would not prevent compliance with existing Court orders. In the Panel's view, only the Court should be able to make an order which would prevent compliance with pre-existing Court orders.

Current division of powers between the Court and the Panel under the Takeovers Act

81 At a very high level, the Panel's enforcement role under the Takeovers Act is to address immediate issues intra-transaction, with the Court's role being that of the final arbiter where more significant measures can be taken.

82 The Panel considers that the Takeovers Act balances two competing considerations well:

(a) Takeovers are time-sensitive transactions – issues such as misinformation can have an outsized and lasting effect if not addressed rapidly. It is important that issues are addressed rapidly so that shareholders can determine whether it is in their interests for a Code regulated transaction to proceed or not. This is preferable to dealing with misconduct after the event, where damages may be difficult to prove and quantify. Rapid resolution of this kind lends itself to a body such as the Panel, which can promptly convene its expert members, and which is not subject to competition for the Court's time and resources.

(b) The Court is the best venue for making more considered and final decisions which will affect matters such as contractual and property rights.

83 In the Regulatory Alignment Paper, the Panel proposed to apply the Takeovers Act enforcement powers to Code company schemes, with various technical adaptations to appropriately reflect the scheme context.[21]

84 As noted in the section on rule 64 above, the Panel's consultation also proposed two different approaches to manage enforcement of civil and criminal misleading or deceptive conduct as between the FMCA/FMA and the Takeovers Act / Panel (the Single Regulatory Approach and the Dual Regulatory Approach).

85 As a related matter, the Panel proposed to align the trigger for when the Code applies to schemes with the existing thresholds in the Code. Currently, the Panel has a role in relation to schemes which "affects the voting rights of a code company". In contrast, rule 6 of the Code applies restrictions where a person's holding or control of Code company voting rights reaches or exceeds certain control thresholds, the key threshold being 20%. Currently, section 236A applies to schemes that affect the voting rights of Code companies, even if the change to the voting rights would not breach rule 6.

Consultation submissions

86 Most submitters agreed with the Panel's proposed approach to extending the Panel's enforcement powers to Code company schemes, so that the Panel's enforcement powers would enable it to address immediate issues via temporary orders and, if necessary, to preserve the status quo, while the Court would have jurisdiction to make any permanent orders.

87 Submitters did not have any comments on the Panel's technical proposals to adapt the enforcement regime to the Code company scheme context.

88 Submitters were split on how regulation of criminal misleading or deceptive conduct should be treated – both regarding whether it should be regulated by the FMCA and the Takeovers Act or just one regime, and, if it was only one regime, which regime should apply.

89 One submitter provided a different suggestion – that the FMCA (alone) should apply to criminal conduct in both schemes and Code offers, given the FMA's resources and expertise.

90 There was support for (and no opposition to) the proposal to align the trigger to section 236A of the Companies Act with rule 6 of the Code.

Analysis and recommendations

Proposed approach to enforcement powers

91 The Panel recommends extending the Panel's enforcement powers to schemes by using, with some modification, the current framework in the Takeovers Act. The proposals are described further below.

[21] Proposals are discussed in more detail below but these included, for instance: a provision under the Takeovers Act that the Panel may not issue temporary restraining orders or permanent compliance orders where they would prevent compliance with Court orders regarding a scheme (with the ability for the Panel to apply for Court orders to this effect instead); repeal of Companies Act and Takeovers Act sections that provide that the Code does not apply where final Court orders have been made; and amendment of section 236A of the Companies Act so that the trigger for this section aligns with rule 6 (rather than being any scheme that 'affects the voting rights' of a Code company, which currently captures immaterial change of voting control schemes).

92 As to the Panel's reasoning:

(a) The division between the roles of the Court and the Panel in the Takeovers Act reflects the Panel's suitability to rapidly address issues intra-transaction and the Court's capability to make broader and more permanent orders. This approach also helps ensure natural justice is not compromised and maintains a division of regulatory functions that has worked well for over 20 years.

(b) Further, the Panel considers that the current Takeovers Act framework is well suited to the supervision of Code company schemes. The Panel's focus should be on time-critical process matters, with disclosure being a key concern, vis-à-vis the Court whose natural focus is on more permanent matters (including the ultimate decision as to whether to sanction the transaction).

(c) Careful drafting of amendments to the Takeovers Act will ensure that:

(i) the Panel cannot make orders which would contradict Court orders; and

(ii) there is nonetheless an appropriate avenue for seeking enforcement orders.

(d) Code company schemes and Code takeovers are, to an extent, interchangeable, and it is at least theoretically possible to run a 'dual track' Code takeover and scheme (as has occurred several times recently in Australia). In order to sensibly deal with such structures, the Panel considers consistency of enforcement approach is preferable to avoid difficult jurisdictional questions.

(e) The Court's role in Code company schemes does not typically start until several months after the SIA has been signed and announced (and several more months after negotiations commenced). Until such time as an originating application is made to the Court, there is no Court case in which the Panel can become involved, yet issues going to the equity or transparency of a transaction can still arise in this pre-Court period. Rather than try and develop a new process through which the Panel could seek orders regarding a future application to the Court for a Code company scheme, the Panel should be able to address any issues within its purview through existing and familiar processes.

93 The Panel's recommended approach to applying each category of the Panel's powers to Code company schemes is set out below:

(a) <u>Investigative Powers</u>

(i) The Panel recommends that its Investigative Powers operate much as they would in a Code offer. These powers focus on information gathering and can be applied directly in relation to Code company schemes. This power is important to ensure that the Panel can access necessary information when a potential enforcement matter arises.

(ii) As to how any information the Panel acquires might be relayed to the Court in practice, the Panel's view is that:

(A) If, after receiving information, the Panel concludes that there is no potential enforcement matter, because, for example, the information gathered provides adequate explanation or the parties involved adequately address the issue prior to the Court's involvement, then the Panel expects it would not draw the information to the Court's attention.

(B) If the information reveals a matter of concern which is not satisfactorily addressed or could not be addressed through the Panel's enforcement powers, then the Panel expects it would draw the matter to the Court's attention.

(iii) To this end, the Panel recommends amending section 31E of the Takeovers Act, to provide an additional exception to the restriction on disclosing information acquired in the course of the Panel's inspection power under section 31A, so that information so gathered may be provided to the Court in relation to a Code company scheme that is before the Court.

(b) Temporary restraining orders

(i) The Panel recommends extending its power to make temporary restraining orders to Code company schemes, but those powers should not conflict with Court orders.

(ii) Additionally, the Panel recommends amending the Takeovers Act to state that the Panel may not make an order where compliance would result in a person being required to do or not do something which would breach Court orders in relation to a Code company scheme or make compliance with Court orders impossible.

(c) Permanent compliance orders

The Panel recommends extending the Panel's power to make permanent compliance orders in respect of disclosure, or non-disclosure, matters in Code company schemes, provided that the Panel should not be able to make an order that conflicts with existing Court orders.

(d) Civil remedy orders and undertakings

The Panel recommends extending the Panel's power to apply to the Court for civil remedy orders and to receive and enforce undertakings in relation to Code company schemes. These remedies cannot conflict with the Court's jurisdiction, as their exercise depends on the Court issuing the orders under the Takeovers Act.

(e) Other technical changes to enforcement powers under the Takeovers Act

If any Code rules are extended to Code company schemes (according to the implementation process outlined at paragraph 98 below), the enforcement provisions of the Takeovers Act will automatically apply in relation to breaches and potential breaches of those rules. A number of Takeovers Act provisions would be directly relevant to addressing issues in relation to Code company schemes (e.g., under section 33J(i), the Court would be able to issue a civil remedy order requiring variation or cancellation of an SIA). However, given the structural differences between Code company schemes and Code regulated transactions, the Panel recommends that further amendments to the Takeovers Act are made to adapt enforcement powers and remedies to schemes, as follows.

(i) *Civil remedy orders regarding voting direction*

(A) Under sections 33F and 33G of the Takeovers Act, the Court may grant an injunction restraining a person from doing something in contravention of the Code (a prohibitory injunction). In the 2022 Recommendations, the Panel noted that under these sections, the Court might not have the power to order a person to take a positive action (a mandatory injunction) and recommended that this be clarified by an amendment expressly granting the Court the jurisdiction to grant a mandatory injunction.

(B) Unless and until this amendment is made, it is unclear whether the Court has an injunctive power to require persons to vote on a Code company scheme in a certain manner (for instance,

to vote consistently with their public statements).[22] The Panel recommends that the Court should be given a specific power under section 33J of the Takeovers Act to direct persons to vote a certain way (or to accept an offer).

(ii) *Ability to enforce payment of consideration*

(A) Under the 2022 Recommendations, the Panel recommended that the Code be amended to require payment of consideration when due in a Code offer. The Panel recommends that an enforcement power should be introduced requiring that a person pay the consideration promised under a Code company scheme.

(B) The Panel recommends that section 33J (civil remedy orders that may be made by the Court) be amended to include an order requiring payment of consideration. The Panel recommends that the power be permissive, as it may be appropriate for orders to facilitate the payment of the relevant funds.

(iii) *Extension of persons who may apply to and be heard in the Court*

(A) Sections 35(1), 35(3) and 44V of the Takeovers Act set out the persons who may apply to or appear and be heard in the Court following the Panel's consideration of a Code matter. These lists include takeover offerors who have made an offer within the last six months.

(B) The Panel recommends that sections 35 and 44V be amended so that any parties to an SIA for a Code company scheme which is either on foot, or was on foot in the previous six months, are added to the lists of persons who may apply to and be heard in the Court.

(iv) *Ability of Panel to accept Undertakings subject to requirement not to cut across Court orders*

The Panel recommends amending section 31T so that while the Panel may accept Undertakings in the ordinary course, where the Court has made orders in relation to a Code company scheme, the terms of any Undertaking must not require a person to do something (or not do something) which would breach the Court orders or make compliance with the Court orders impossible.

FMCA/FMA and Takeovers Act / Panel division

94 Regarding the FMCA/FMA and Takeovers Act / Panel regulatory division, the Panel considers a Single Regulatory Approach to be preferable. However, the Panel thinks the optimal approach is to divide

[22] The Panel notes that there may still be alternative but less direct remedies available if a person does not act consistently with their public statements.

responsibilities along criminal / civil lines, reflecting the Panel's emphasis on dealing with matters intra transaction and the FMA's prosecution capabilities. Accordingly, the Panel recommends that:

(a) regulation of civil misleading and deceptive conduct in relation to schemes should move from the FMCA/FMA to the Code/Panel (leaving all civil enforcement in relation to change of control transactions under the Code / with the Panel); and

(b) regulation of criminal misleading and deceptive conduct of takeovers should move from the Code/Panel to the FMCA (leaving all criminal enforcement in relation to change of control transactions with the FMCA / FMA).

95 Specifically, the Panel recommends:

(a) The criminal provisions in the Takeovers Act relating to misleading or deceptive conduct (sections 44B and 44C) be repealed. The Panel recommends retaining the general offences under section 44 as they relate to misleading the Panel rather than the public.

(b) Section 262 of the FMCA be extended so that it applies to Code-regulated transactions (including in relation to non-listed Code companies) and the exception for takeovers in section 263 of the FMCA be repealed.

(c) Section 44B of the Takeovers Act be replaced with a new section 44B setting out applicable rules regarding proceedings where there may be offences under the FMCA, including provisions that:

(i) a person cannot be liable for a fine under the FMCA and liable for a pecuniary penalty under the Takeovers Act for the same conduct; and

(ii) where the Panel is considering seeking a pecuniary penalty against a person, it must give notice of its intent to commence such proceedings to the FMA and must not commence such proceedings until six months after notice is provided, unless the FMA advises that it does or does not intend to prosecute any corresponding FMCA offences, or where compliance with the six-month notice period would result in the expiry of a limitation period in relation to the pecuniary penalty proceedings.

96 The Panel further recommends that it should be clarified that a party cannot be liable for a criminal sanction where they have been ordered to pay a pecuniary penalty (and vice versa).

97 The Panel notes that the FMA has yet to conclude whether or not it supports the Panel's recommended approach. The Panel has given the FMA's views (received to date) careful consideration and considers that the Panel's proposed approach is preferable as it promotes simplicity in regulation by:

(a) avoiding potential duplication of standards (and/or variations in those standards); and

(b) simplifying market participants' interface with regulators.

98 The Panel considers that the best approach forward on this point is to engage further with the FMA once a policy decision is made to progress these recommendations. The Panel's key drivers in this regard are:

(a) ensuring the effective regulation of schemes (which the Panel considers requires the application of relevant Code rules to schemes over which the Panel has direct jurisdiction);

(b) providing for the simplest regulatory environment possible; and

(c) utilising the respective strengths of the Panel and the FMA to the extent possible.

99 The Panel has also identified the following reforms that would be required to adapt the regulatory regime under the Code and the Takeovers Act to the Code company schemes context:

(a) Amendments to apply to Code company schemes – the Code, the Companies Act and the Takeovers Act

(i) If schemes are to be regulated by the Code, the Panel recommends the following:

(A) Repeal of section 236B of the Companies Act and repeal of the current section 23A of the Takeovers Act (provisions that provide that the Code does not apply where final orders have been made), so that schemes are restricted by rule 6 of the Code.

(B) Adding Code company schemes to the list of transactions in rule 7 of the Code by which a party may increase their control in a Code company in a way which would otherwise contravene rule 6.

(C) Amendment of the relevant rules of the Code to be clear, as necessary, whether they do or do not apply to Code company schemes.

(ii) The Panel recommends that section 236A of the Companies Act be retained and that the current No-objection Statement process be preserved, so that a Code company scheme could not be approved unless:

(A) the Court is satisfied that the shareholders of the Code company will not be adversely affected by the use of a scheme rather than a Code offer (see section 236A(2)(b)(i)); or

(B) the Panel provides a No-objection Statement (see section 236A(2)(b)(ii)).

(iii) The Panel recommends amending the Panel's functions under section 8 of the Takeovers Act to apply to 'code-regulated schemes of arrangement' and be extended to include considering whether or not the Panel has an objection to such an order, advising relevant parties of the Panel's view, and making submissions to the Court in respect of such an order.

(b) Takeovers Regulations: As discussed above, the Panel recommends that the trigger for the application of section 236A align with rule 6 of the Code. The Panel also recommends that the drafting of regulation 4(2)(b) of the Takeovers Regulations 2000 (regarding the Code company schemes services for which the Panel may charge fees) be updated to align with the new trigger for the application of section 236A.

(c) Code company amalgamations:

(i) Where a Code company amalgamates with another company (or other body corporate) under a scheme, and the Code company is not the continuing entity, the Panel recommends that the Code deem that the other amalgamating entity (i.e., not the Code company) be deemed to have become the holder of all of the voting rights of the Code company.

(ii) This proposal is an anti-avoidance measure seeking to ensure that amalgamations are captured by the Code.

100 Finally, the Panel is conscious that the exceptions to the insider trading regime in sections 252, 253 and 254 of the FMCA do not apply in the same manner to Code offers and schemes. The Panel considers that the current exceptions which apply in relation to Code offers should apply in relation to both transactions. The Panel has not consulted on this particular change, but considers it to be a technical point and any consultation can be dealt with through the legislative process.

Deal protection devices

Regulation of deal protection devices

The problem

101 Deal protection devices are obligations that, in a scheme or Code offer, restrict the target's ability to engage with competing offerors and/or impose consequences on a party for not complying with that obligation or otherwise not proceeding with the transaction.

102 Broadly, deal protection devices fall into two categories:

(a) Exclusivity arrangements: Examples include:

(i) *No-shop*: where the target agrees not to solicit competing proposals;

(ii) *No due diligence*: the target agrees to not provide any third party with due diligence access;

(iii) *No-talk*: the target agrees to not engage or negotiate with a competing offeror;

(iv) *Superior proposal exception*: the target board may only engage with a competing offeror if the competing bid meets certain criteria;

(v) *Matching rights*: where a competing proposal is made, the original offeror has a right to match or better the offer; and

(vi) *Notification obligations*: the target agrees to notify the offeror of, and provide details regarding, an approach made by a competing offeror.

(b) Break fee arrangements: In general terms, a break fee is an amount payable by a target to an offeror if specified events occur and the offer fails. Break fees are described by reference to the events which trigger their payment. They may include the following:

(i) *Competing proposal break fee*: payable if a competing transaction is completed before the agreement is terminated or within a certain time after termination;

(ii) *No recommendation break fee*: payable if the target directors fail to recommend a scheme to their shareholders (provided the offer price is within or above the independent adviser's valuation range); and

(iii) *Regulatory approval break fee*: payable if certain regulatory approvals – e.g., Commerce Commission approval, is not received.

103 The concern with deal protection devices is that they can restrict competition for control of a Code company by discouraging alternate proposals from being made, meaning that shareholders do not have the opportunity to consider the merits of a competing proposal.

104 However, because deal protection devices can reduce the potential for further competition, they can be pro-competitive as they can elicit an offer, or an offer on more favourable terms, which may not otherwise be made.

105 This means the impact of deal protection devices varies depending on the specific terms and circumstances. Determining the appropriateness of a deal protection device depends on the particulars of the device, what

other deal protection devices that are in the agreement and the surrounding context, making it a nuanced, context specific assessment.

Current regulation of deal protection devices in New Zealand

106 There is no specific rule regulating deal protection devices in public takeovers in New Zealand. However, there are restrictions which can limit, with varying degrees of effectiveness, what deal protection devices might be agreed to or enforced. In broad terms these restrictions are:

(a) Code offers: Rule 38 of the Code restricts the target from taking actions, during (and shortly before) a Code takeover offer, that might frustrate the offer or have similar effects. Under certain circumstances, specific deal protection devices may trigger rule 38, meaning their use could potentially be regulated under the Code. However, there are limitations to using rule 38 as a regulatory device for deal protection devices. The Panel considers these limitations mean rule 38 is an inappropriate mechanism to provide regulation for deal protection devices. The limitations include:

(i) rule 38 only applies to Code offers and not to schemes;[23]

(ii) rule 38 does not restrict the use of deal protection devices where negotiations are incomplete; and

(iii) only some deal protection devices may trigger rule 38, while other, potentially more unduly restrictive or anti-competitive devices, may not.

(b) Schemes: The Panel may take into account deal protection devices when considering whether to grant a No-objection Statement. Furthermore, the Panel might also consider making submissions to the Court in relation to deal protection devices. While these two processes provide a means for potentially regulating deal protection devices in schemes, the Panel considers that they are inappropriate for the following reasons:

(i) they only work with schemes and not Code offers;

(ii) there is no clear means to address unduly restrictive deal protection devices as they arise, meaning the Panel would only be able to address them during the Court process, when the competitive advantage has likely already been gained.

Consultation and Submissions

107 There was moderate support for the regulation of deal protection devices, although some submitters considered that guidance alone would be more appropriate. Two submitters went further and opposed any Panel involvement with deal protection devices.

108 Should there be regulation, there was near consensus that it should apply to both Code regulated transactions and schemes and regulate both exclusivity arrangements and break fees.

109 There was a moderate level of support for regulating deal protection devices prior to the announcement of the offer. Those who supported regulation considered that the use of deal protection devices during this period was designed to reduce competition for control of Code companies.

110 The submitters' more detailed points regarding potential reform were:

[23] This is because the triggers of rule 38 are a takeover notice or a bona fide offer being imminent. In a scheme, there is no takeover notice, nor is there an "offer" (offer being defined in the Code and only relating to Code offers, not proposals in relation to a scheme).

(a) There was a moderate level of support for the Panel's proposed approach to reform, but submitters emphasised the need for any regulation to be paired with clear guidance.

(b) A majority of submitters stated that the Panel should be careful to not take too prescriptive an approach so as to leave flexibility for target boards.

(c) There was a mixed response on whether there were any 'bright lines' that should be included in potential regulation. A number of submitters considered that if there were to be 'bright lines', it would be better to include them in guidance rather than regulation.

(d) There was a mixed response on the issue of seeking to standardise break fees. While some submitters considered that a 1% break fee standard was appropriate, there were concerns about including this in a rule. Instead, it was suggested guidance may allow for greater flexibility. However, some submitters opposed specifying limits on the basis that setting limits could encourage their use up to the limit.

(e) The majority of submitters considered there would be limited circumstances when a superior competing proposal clause should not be required in deal protection devices, but that guidance may be appropriate in this area.

(f) There was a strong degree of support for target boards being able to agree to no-shop provisions, provided they included the ability to respond to a superior competing proposal.

(g) There was agreement amongst the submitters that a target board should not be obliged to conduct an auction process. However, submitters considered that where a target board had chosen to undertake an auction, it may justify agreeing to more restrictive deal protection devices.

(h) There was a mixed response on whether 'mirroring' a break fee could justify the level of a reverse break fee. While some submitters considered 'mirroring' could help justify the quantum, others argued that the triggers for break fees and reverse break fees often differ, meaning one should not automatically justify the other.

Analysis and Recommendation

Panel analysis

111 The Panel considers deal protection devices should be regulated through the development of a new Code rule (the **New DPD Rule**).

112 The Panel's reasons are that:

(a) By limiting competition for control of Code companies and deterring competing offers, deal protection devices impede shareholders' ability to assess the merits of an offer and conflict with one of the Code's key objectives.

(b) As outlined in paragraph 106, the existing mechanisms for potentially regulating deal protection devices are not robust and have a limited scope, resulting in inconsistent coverage across Code offers and schemes. Consequently, they are ill-suited for effectively regulating deal protection devices.

(c) Regulating deal protection devices and requiring their disclosure would encourage discipline amongst market participants. Specifically, target boards may exercise greater caution when negotiating deal protection devices, given the potential scrutiny from both shareholder and regulators.

(d) Regulating deal protection would align New Zealand with Australia and other comparable foreign jurisdictions.

113 The Panel intends if the New DPD Rule is established, it would publish accompanying guidance. The guidance would aim to articulate clear expectations for market participants and establish a framework of how the Panel would likely interpret and apply the New DPD Rule.

114 While some submitters expressed a preference for the Panel to solely offer guidance on deal protection devices, the Panel considers that in the absence of a robust set of regulatory mechanisms, such guidance would be optional. This could create ambiguity in its purpose and risk increasing uncertainty for market participants.

Panel Recommendations

115 The Panel recommends the Code be amended to:

(a) include a definition of deal protection devices in rule 3 'Interpretations' covering any agreement or arrangement enforceable against a Code company or its directors which:

(i) restricts the actions which a Code company (or any of its directors) may take in relation to a transaction (or proposed transaction) which would be regulated or restricted by the Code;

(ii) has, among its purposes, encouraging or facilitating a transaction in relation to the Code company which would be regulated or restricted by the Code; and

(iii) will or may hinder, prevent or reduce the attractiveness of another transaction from being proposed or coming into effect; and

(b) develop a new rule which provides:

(i) a Code company must not enter into a deal protection device which unreasonably inhibits competition for control over that Code company; and

(ii) factors which may be considered when determining whether a device has the effect of unreasonably inhibiting competition for control over a Code company.

Functions of the Panel

<u>The problem</u>

116 In general terms, the Panel charges fees in relation to the vast majority of work it undertakes in relation to schemes as this is done in connection with determining whether or not to issue a no-objection statement. This contrasts to Code regulated transactions, where (in general terms) the Panel may charge in relation to section 32 meetings, but not in relation to the review of draft documents.

117 If schemes were to be regulated in the manner proposed in these recommendations, there would be an uncertainty as to whether the Panel was acting to review documents in connection with determining whether to issue a no-objection statement or to assess compliance with the Code.

118 A related point is that the Panel has been running structural deficits for some time. In part, the Panel considers that this results from the relatively arbitrary nature of the work for which it can and cannot charge fees.

119 While policy work as to the Panel's fees has commenced, the Panel has not yet formed any view as to the appropriate approach to Panel fees, nor has it conducted full consultation on the topic (although it has engaged with some market participants on an informal basis).

120 The Panel wishes to emphasise that it does not wish to prejudge the outcome of the ongoing work in relation to its fees. However, the Panel is conscious that:

(a) if the outcome of this work is that the Panel should charge fees in relation to the review of non-scheme documents, the Panel's objectives may need to be amended to more specifically cover the work for which charges might be imposed;[24]

(b) as a result, legislative change would be required before changes to fees were made through regulations; and

(c) given the pressures on Parliament's time, legislative change to the Takeovers Act could be delayed.

Analysis and recommendations

121 The Panel recommends amending the functions of the Panel in section 8 of the Takeovers Act to include:

(a) monitoring any transactions which are, or may be, regulated by the Code;

(b) reviewing any documents, statements and communications (and drafts of any of them) which relate to any transactions referred to in (a) and considering whether any such documents, statements or communications comply with the Code;

(c) liaising with relevant parties as to whether any potential compliance issues exist in relation to any transaction which is, or may be, regulated by the Code, and, if so, how such issues should be addressed; and

(d) considering whether the Panel should exercise any of the Panel's powers or functions in relation to the foregoing.

122 While these changes have not been consulted on yet, the Panel considers that they are simply reflective of the Panel's current operations so are a technical and uncontroversial change which does not require consultation. Any changes to the Panel's fees can be separately considered as part of a further consultation.

[24] The Panel is not aware of any strict legal requirement for the Panel's objectives to capture work for which a fee may be imposed. However, the Panel understands that New Zealand government policy is to only impose fees for work which tracks through to the objectives of a Crown entity.