THE REGULATORY FRAMEWORK FOR COMPANY TAKEOVERS IN NEW ZEALAND

James Farmer QC

I The Statutory Framework and Regulatory Institutions

(a) Introduction

Company takeover law in New Zealand is presently in the melting pot. Following its earlier report on insider trading,[1] the Securities Commission has now published a comprehensive report to the Minister for Justice on company takeovers.[2] Parliament has recently enacted changes to the Securities Act which regulate insider trading and also the controversial futures industry.[3] The Minister has promised legislation to enact the major recommendations of the Securities Commission on takeovers. In particular, a person who passes the 30 per cent threshhold of ownership will be required by law to bid for the whole company at a price that is not less than the highest paid for acquisitions in the preceding 12 months or the market price immediately before the bid is announced, which is the higher.

The Law Commission is due to report to the Minister on Company Law reform, following publication last year of its Discussion Paper.[4] That report is likely to recommend the strengthening of the duties of company directors[5] and may go so far as to impose specific duries on the directors of offeree companies.

All of these changes are being considered in a commercial and economic environment that is far from healthy. The stock market crash of October 1987, the subsequent collapse of large public companies, including most recently and most notably Equiticorp, the public revelation of secret transactions of doubtful legal validity and commercial propriety and the failure of many

high-flying company directors to observe fundamental notions of fiduciary obligation have all contributed to a feeling that New Zealand financial markets are completely lacking in integrity and that regulatory controls are either non-existent or at best totally inadequate. Added to that is a current political and economic environment that has such features as high unemployment, a multitude of corporate and individual insolvencies, concerns about foreign ownership and a degree of political instability resulting from the dismissal or resignation of high-ranking Government Ministers.

Commercial law reform, including changes to takeover laws, is being considered therefore in an atmosphere that does not lend itself to rational and considered debate. Much emotion, some of it justified but some not, has been engendered by particular transactions. Take for example the various moves made during 1987 in relation to what used to be the largest company in New Zealand - NZ Forest Products Limited: the establishment of Rada Corporation by NZFP, its public flotation, the purchase by it of a substantial part of NZFP as a defensive mechanism to an unwelcome suitor in the form of Fletcher Challenge Limited, the refusal by the Commerce Commission to authorise a takeover of NZFP by the Australian Amcor Corporation, the subsequent insolvency of Rada, the Justice Department Report on the incestual financial transactions occurring between NZFP and Rada and the eventual reverse takeover of NZFP effected by Elders and buy-out of the Fletcher holding in return for important forestry and wood product assets. Little wonder that this led to a conviction by many that minority shareholders were but pawns in the corporate world and that they lacked proper protection under existing corporate and securities laws.

Concern for the position of minority shareholders was also behind the decision of the Securities Commission to hold a public inquiry into the Lion Corporation merger with L.D. Nathan & Co Limited, following a purchase by Lion of 35 per cent holding which was held by Fay Richwhite & Co Limited in Nathan at a price substantially above the value of the public offer made by Lion to the remaining Nathan shareholders. The inquiry before the Commission was lengthy and was accompanied by High Court proceedings brought by a minority shareholder in Lion seeking to frustrate the merger.[6] Some of the comment that accompanied and took place within the Inquiry was ill-informed and unconstructive but the exchanges between the Chairman of the Commission and Professor John Pound, a United States economist brought to New Zealand for the Inquiry by Fay Richwhite, raised the debate on shareholder equity to a level that was more worthy of the disappointing recommendations later published by the Commission.

What the Lion-Nathan inquiry did heighten, however, was the tension that exists between economic efficiency, on the one hand, and shareholder equity, on the other. Not surprisingly, economists such as Professor Pound and Mr Peter Gorringe from the Treasury argued forcefully that great benefits result from takeover activity, that it promotes corporate efficiency and increases shareholder wealth.[7] By contrast, minority shareholder advocate Mr Max Gunn and former Attorney-General Dr Martin Finlay QC emphasised that securities rank pari passu and that holders should therefore receive equal treatment not only on a winding up but in a takeover situation as well.[8] The resolution of this conflict determines the kind of takeover laws that a country has. New Zealand appears to have chosen the equal treatment solution and to have rejected the case for economic efficiency and increased shareholder wealth, tempered by the strengthening of the

fiduciary duty to prevent abuse, so elequently advocated by Professor Pound.

(b) The Existing Law

Company takeovers and mergers in New Zealand are regulated under statute by the Companies Amendment Act 1963, by the Commerce Act 1986 and, where the offeror is an overseas person (including within that term a foreign corporation), by the Overseas Investment Act 1973. While not concerned specifically with company takeovers, the Fair Trading Act 1986 is also of relevance. In addition, it is necessary to refer to the Takeover Code contained in the Listing Requirements of the New Zealand Stock Exchange, although those provisions are strictly speaking contractual in nature notwithstanding that the Exchange is created by statute.[9]

The statutory institutions charged with administering these various provisions are the Registrar of Companies (Companies Amendment Act 1963), the Commerce Commission (Commerce Act 1986 and Fair Trading Act 1986), the Overseas Investment Commission (Overseas Investment Act 1973) and the New Zealand Stock Exchange (Takeover Code). Although not given any specific enforcement powers, the Securities Commission, which is established by the Securities Act 1978, has however proved to be a highly influential and significant body in this area. Relying on its "law reform" recommendatory powers, the Commission, as will be seen below, has investigated takeovers during their currency, by way of both public and private inquiry, in order to satisfy itself that there is no irregularity or unfairness emerging that requires legislative attention.[10] Ultimately, however, its lack of statutory enforcement powers has rendered it far less effective than its Australian counterpart, the National Companies and Securities Commission.

(i) Companies Amendment Act 1963

Prior to 1963 there had been no specific controls on takeover offers contained in the Companies Act, though there were (and are) provisions by which an offeror which had succeeded in acquiring nine-tenths of the company (excluding shares already held by the offeror) within a period of 4 months could compulsorily acquire the shares of the dissentient shareholders subject to the right of the latter to object by application to the High Court.[11]

The Companies Amendment Act of 1963 introduced what has been referred to as a "takeover code". The inappropriateness of that description was demonstrated by a number of Court decisions, beginning with that of the Court of Appeal in 1966 in Multiplex Industries Limited v. Speers.[12] In that case, it was held that the Act only applied to offers that were made in writing and did not extend to oral bids. There later followed in 1983 the judgment of Mahon J. in Carter Holt Holdings Limited v. Fletcher Holdings Limited[13] in which it was held that an initial purchase of a substantial shareholding, made pursuant to a verbal offer and intended to give the offeror a "toehold" in the target company, did not come within the statutory definition of "takeover scheme",[14] notwithstanding that it was made immediately before the formal written statutory offer was made.

The ambit of the Act was further reduced by the judgment of Quilliam J. in Tatra Industries Limited v. Scott Group Limited.[15] The Court there held that the Act had no application to purchases on the Stock Exchange even although the brokers acting for the bidder had given notice to the Exchange to stand in the market, as required by the Rules of the Exchange. Reference should also be made to Carr v. New Zealand Refrigerating Company Limited[16] where the High Court took a generous approach to

what was regarded as "substantial compliance" with the Act, notwithstanding a number of procedural contraventions.

Finally, there is an express statutory exemption[17] in the case of offers that are made to not more than 6 members of a company. In practice, this provision has been used on occasion to circumvent the Act by using a broker to collect together a large number of small parcels into the confines of a single nominee company to which the offer is then made.

Not surprisingly to practitioners in this field, the Securities Commission (in its Report Company Takeovers) had little compunction in describing the 1963 Amendment Act as "an inept piece of legislation that should be repealed in any event."[18] It further pointed out that the Act had the opposite effect from its apparent policy objectives:

> "One remarkable feature of this is that the 1963 Act itself operates to induce offerors to make personal approaches to selected shareholders with substantial holdings to the exclusion of other shareholders with relatively small holdings. Certainly the 1963 Act has failed to achieve the purpose, if such it was, of giving all shareholders the opportunity to respond to a takeover offer. On the contrary, it has induced discriminating treatment by leaving open the way to takeovers by agreement with some substantial shareholders, and impeding an approach to all shareholders that is feasible only by written offers with the formality and disclosures required by the 1963 Act. If the object to the Act was to improve the position of the general body of target shareholders, the object has not been achieved. On the contrary, the promoters of this legislation succeeded in scoring a remarkable 'own goal' against them. The Act promotes the very kind of takeovers, partial, sudden, secret and by word of mouth, that the promoters intended to inhibit."[19]

(ii) Stock Exchange Rules

Take-over activity or potential takeover activity is regulated in two ways by the Rules of the Exchange. First, there is the "substantial shareholding" requirement that obliges a member of the Exchange who has received instructions to purchase more than 10 per cent of the voting shares in a listed company to bid for not less than one-fifth of the proposed purchase at a trading meeting after prior notice has been given to the Exchange at least 20 minutes before the beginning of that meeting.[20] Secondly, there is the Take-over Code.

The Take-over Code is directed towards:

(1) establishing duties on directors of both offeror and offeree to act in the best interests of shareholders, to make full disclosure to the Exchange and to all shareholders and not to allow insider trading to develop where a possible takeover exists;[21]

(2) requiring sufficient information to be given to shareholders of the offeree company to enable them to make an informed decision on whether to accept the offer[22];

(3) preventing the Board of the offeree company from engaging in defensive takeover tactics "unless it honestly believes that acceptance is not in the best interests of shareholders" and in any event foreclosing the issue of unallotted voting shares without the sanction of a general meeting as a defensive measure[23];

(4) guaranteeing equal treatment for offeree shareholders.[24]

Consideration of this last objective dominated the Report of the Securities Commission into Company Take-overs and, more specifically, the Lion-Nathan Inquiry. It therefore deserves closer examination. Rule 612 provides that all holders of the same class of security are to be "treated similarly" by the offeror except that allotments of small parcels of shares may be satisfied by cash. It is to be observed that in a note to the rule the Exchange says that an offeror is entitled to make a partial bid provided that every offeree who accepts has the same percentage of his shareholding taken up. The subject of partial bids has been a highly controversial one, particularly in recent times in Australia.[25] The effect of the recommendation made by the Securities Commission to the Minister for Justice (and adopted by him) requiring persons who have acquired by any means 30 per cent or the company to offer to purchase all the voting securites issued by the company[26] will be to outlaw partial bids in New Zealand over the 30 per cent threshhold level.

Rule 613 provides that where a takeover or merger transaction is reasonably in contemplation and shares are purchased from one or more shareholders of an offeree company, any subsequent general offer made by the same offeror (or person acting in concert with it)[27] within 3 months to the remaining holders of the same class of security must not be on less favourable terms.[28] Similarly, increases in consideration or price within a 3 month period must be passed on to all offerees, whether or not they have already accepted the offer.[29]

In the Lion-Nathan merger, the first of these rules had not been observed in that Fay Richwhite was offered a cash price by Lion of $9.20 per share for its 35 per cent holding in Nathan whereas the offer to the remaining Nathan shareholders was for scrip and valued at about two-thirds of the Fay Richwhite price. The Stock Exchange,

however, waived compliance with the requirements of rules 612 and 613, under a general power which it had to dispense with the observance of any of its Rules, on condition that the offer was accepted by a majority of Nathan shareholders excluding those with a particular interest in the merger. That condition was satisfied. In announcing the grant of the waiver, the Exchange acknowledged that the 3 month requirement could all too easily be circumvented by the simple expedient of delaying the general offer. The Exchange called for the enactment of "effective takeover law", arguing for equality of treatment of all shareholders and concluding that any other course would harm the international appreciation of the New Zealand market and render harmonisation of trading with the Australian market impossible.[30]

(c) Commerce Act and Fair Trading Act

As is well known, the 1986 Commerce Act introduced into New Zealand a radically different regime of competition law and policy. In accordance with the dictates of the Closer Economic Relations Treaty Agreement,[31] the New Zealand Parliament adopted the model employed in Australia in the form of the Trade Practices Act 1974, though with a number of detailed differences. One of the more significant of such differences was in the area of regulation of takeovers and mergers. The Australian provision simply prohibited any takeover or merger that had the effect of substantially lessening competition in a market.[32] When enacted in 1974, the Act contained a prior clearance system but this was removed in 1977. Accordingly, since that time the Australian Act has relied on powers of divestment[33] and on the power of the Trade Practices Commission to seek injunctions from the Court against the implementation of takeovers that appear to infringe that statutory prohibition. In practice much informal prior consultation occurs.

By contrast, the New Zealand Act imposes a legal obligation to obtain clearances or authorisations to takeovers or merger proposals before they are implemented.[34] Section 50(2) of the Act prohibits any person, either by himself or jointly or in concert with any other person, from implementing a merger or takeover proposal to which the section applies unless a clearance or authorisation to the proposal is implemented in accordance therewith. The prohibition only applies where the threshhold levels as to proportion of shareholding (20 per cent)[35] and aggregate value of assets of participants in the proposal[36] are exceeded.

The Commerce Commission, when receiving an application for clearance to a merger or takeover proposal, is required within 20 working days thereafter either to grant a clearance if it is satisfied that the proposal, if implemented, would not result or would not be likely to result in any person[37] acquiring a dominant position in a market or strengthening a dominant position in a market or, if not so satisfied, by notice to inform the applicant accordingly and thereafter to give a clearance or authorisation or decline to do so.[38] The distinction between a clearance and an authorisation is that the former is granted where the Commission is satisfied that no dominance problem arises whereas the latter may be granted, notwithstanding a dominance problem, so long as the Commission is satisfied that implementation of the merger or takeover proposal "would result or would be likely to result in a benefit to the public which would outweigh any detriment to the public which would result or would be likely to result" from the acquisition or strengthening of a dominant position in a market.[39] The Act gives the Commission a period of 100 working days to consider authorisations,[40] a matter which has been the subject of much criticism in that it may adversely affect the ability to effect a successful takeover, morale among

staff and customers of the target company and also the costs of acquisition where financial markets are changing rapidly.

The whole scheme contained in Part III in relation to merger and takeover proposals is currently under review and various aspects are debated in the Discussion Paper on the Commerce Act published by the Department of Trade and Industry in 1988.[41] A number of specific questions warrant consideration, the major two of which are:

i) Is the pre-transaction clearance system appropriate?

As noted above, a similar system was abandonned in Australia, although undoubtedly much informal notification and consultation with the Trade Practices Commission takes place by companies wishing to avoid the potentially very detrimental effects of injunction or divestment proceedings. There is acknowledged to be a considerable resource cost to the Commerce Commission in vetting the large number of proposals that fall within the Act, even although only a very small number of such proposals are declined (2 out of 332 in the first twelve months of operation of the Act)[42]. The Department nevertheless recommended the retention of the present system, although advocating procedural reforms designed to achieve some simplification.[43] The question of alternative measures is discussed further below.

(ii) How satisfactory are the twin tests of market dominance and public benefit?

It is somewhat odd that Part III of the Act should erect a barrier of market dominance _per se_ when Part II merely legislates against the use of a dominant position in a market for stated anti-competitive

purposes.[44] It is submitted that this apparent policy anomaly requires addressing. The concept of "public benefit" is intended to provide a balance against the undesirable consequences of too slavish an application of the market domination test. The difficulty that exists, however, is that the Act nowhere lays down any definition or provides any criteria or principles by which public benefit is to be measured. It is a matter of legitimate criticism that the 1975 Commerce Act defined "public interest" in terms that were vague, inherently contradictory and lacking in any central principle.[45] The 1986 Act has gone to the opposite extreme in that it fails to give any guidance whatsoever to the Commission or to the Courts. This has, not unnaturally, led to a certain inconsistency in the decisions of both bodies, including the Courts of Australia where a similar problem exists under the Trade Practices Act.[46]

The criticism of inconsistency in the approach to public benefit has been taken up recently by the New Zealand Business Roundtable[47] which suggests that both the Commerce Commission and the High Court have failed "to recognise economic efficiency as the objective underlying, but not specified in, the Act, or to interpret competition as a means to efficiency (and hence consumer welfare) rather than as an end in itself." The consequence, the Business Roundtable concludes, is that there exists in New Zealand "a bias towards intervention, imposing significant economic costs which might be avoided under better designed antitrust rules."[48]

In terms of the adoption of central concepts of competition policy that have international acceptance, the Commerce Act of 1986 as a whole undoubtedly represents a major step forward from earlier trade practices

legislation in New Zealand but the part of the Act that regulates mergers and takeovers is far from satisfactory. It is bureaucratically clumsy and costly, not only to the regulatory body that administers it but also to commerce and industry. It lacks a clear policy objective and, to the extent that one can be gleaned, it is inconsistent with the policy applicable to restrictive trade practices. The Departmental Discussion Paper correctly poses the choice for future policy as being between economic efficiency and a broader, better defined, public benefit principle that takes specific account of social considerations that may conflict with efficiency criteria. The Paper comes down in favour of a view of public benefit that facilitates "the achievement of efficiencies which would not be achievable if the parties to the application were required to comply with the Act."[49] That sounds reasonable but its translation into clear legal criteria may be more difficult.

It is important to appreciate that there are other limitations on the pursuit of economic efficiency as the desired goal. These are to be found in the Fair Trading Act 1986 which has incorporated, with no real change of principle, the provisions of Part V of the Australian Trade Practices Act 1974. In particular, it has adopted the Australian prohibitions against misleading and deceptive conduct in trade and misrepresentations of numerous stated kinds,[50] together with the wide range of legal remedies in respect of such conduct. There is a clear intention therefore on the part of the Legislature that the competition and economic efficiency objectives of the Commerce Act are to be tempered by an overriding requirement that what is done is done honestly and according to standards of conduct that are reasonably protective of the consumer. The point was made clear by the High Court of Australia by Mason J. (as he then was) in Parkdale Custom Built Furniture Pty Limited v. Puxu Pty Limited[51] in the following way:-

"In a collision between one of two different statutory policies and plain words giving effect to the other statutory policy the plain words will prevail. To my mind the words 'misleading' and 'deceptive' as applied to conduct in trade and commerce are reasonably plain. And in a collision between the general policy of encouraging freedom of competition and the specific purpose of protecting the consumer from misleading or deceptive conduct it is only right that the latter should prevail. It would be wrong to attribute to the Parliament an intention that the indirect and intangible benefits of unbridled competition are to be preferred to the protection of the consumer from the misleading or deceeptive conduct which may be an incidental concomitant of that competition. Given the statutory context here it is more likely that Parliament intended to promote free competition within a regulatory framework that prohibits the trader from engaging in misleading or deceptive conduct, even if it means that one trader cannot in particular cases compete with another trader because the opposite view would give a paramountcy to freedom of competition not accorded to it by the statute."[52]

It is of interest and significance that the Courts of both Australia and New Zealand have been willing to consider the application of Part V (of the Australian Act) and the Fair Trading Act respectively to takeover situations. In particular, in Bell Resources Limited v. BHP Co Limited[53] (Australia) and in CBP Industries Limited v. Bowker Holdings No.16 Limited[54] (New Zealand), the Courts appeared to accept that statements made during the course of contested takeovers could be measured against the standards laid down in section 52 or section 9 respectively, although on the facts of each case no substantive remedy was granted.

II Policy Objectives in relation to Takeover Controls

(a) Inter-relationship between Competition Policy and Securities Market Regulation

It has been suggested above that competition policy in relation to mergers and takeovers needs to be re-thought

both with regard to substantive content and to administration. There is also the question of the inter-relationship between the regulatory regime imposed by the Commerce Act and the controls on markets for securities that are laid down in companies and securities legislation and in Stock Exchange rules. This is a matter that was addressed by the Securities Commission in its Report on Company Takeovers.[55] The Commission challenged the view that "effective government intervention in the markets for goods and services may require government intervention in the markets for the control and ownership of the entities that participate in the markets for goods and services." The "case for such intervention ('upstream') and removed from the markets for goods and services," the Commission said, "seems to be weak if there is an open and competitive market for securities and the control of those entities."[56] More than that, the Commission thought the Commerce Act to be positively disabling in that it:

(1) affected securities markets by requiring public notice of a bidder's proposal to acquire shares and by impeding the presentation of a competing proposal[57];

(2) made it possible to "lock up" a target cmmpany by entering into a contract with some shareholders to buy their holdings subject to consent of the Commerce Commission but including provisions designed to prevent acceptance of a competing bid.[58]

The Commission accordingly recommended the total repeal of Part III of the Commerce Act.[58] It is respectfully submitted that there is much merit in these views and that Part III does not in any event stand as a monument to successful public interest legislation.

(b) Policies for Securities Markets - the *pari passu* principle and Lion-Nathan

The Securities Commission addressed this matter at some length.[59] Ultimately, it recommended that statutory reforms be enacted to the following effect:

"(a) a person who, by any means whatsoever, acquires relevant interests in more than 30% of the voting securities of a listed company should be required to offer to purchase each and every one of the voting securities in the company for a consideration equivalent to the highest consideration for any voting security acquired by the person within the preceding 12 months, or the price on the market immediately before the announcement of the offer, whichever is the greater (...the 'mandatory offer'):

(b) prior notice of the offer should be required except where it is an unconditional offer of cash for each and every one of the voting securities that is open for acceptance by each offeree for a reasonable period, say three weeks.

(c) an administrative authority should be established with the powers and resources necessary to administer and enforce the legislation."[60]

The Minister for Justice has publicly announced that these measures will be enacted during 1989.

As has been noted above, the debate before the Commission during the Lion-Nathan Inquiry centred on whether a shareholder in the position of Fay Richwhite - with, say, a 35 per cent holding - should be entitled to bargain for a "premium for control" in a takeover situation or even to stipulate the best negotiable price to a purchaser who is

content to deal with it and it alone. The key to the rejection by the Commission of the solid consensus of most economists that the premium for control was not only a natural market phenomenon but had positive economic benefits for all shareholders and was in the public interest lay in this footnote to its Report:

> "In our opinion, the pari passu principle stated in the text is a major premise, usually inarticulate, of existing company law and practice. We think it is implicit in the concept of a 'share'."[61]

The Commission thought that if the pari passu principle were "perfectly implemented" and share prices set in "perfect markets", market forces would ensure price equality at any given time for the reason that:

> "A rational and efficient market would expect that identical benefits would accrue in future to every ordinary share in the same company, would attach identical present values to those future benefits, and would therefore set identical prices for each of the shares."[62]

In those circumstances, the Commission said, there would be no significant premium for control "because control would not be regarded as conferring any benefit, valuable in terms of money, significantly disproportionate to shareholdings".[63]

Of course, as the Commission itself acknowledged,[64] the New Zealand market does not conform with this expectation. The recommendations propounded by the Commission and accepted by the Minister therefore constitute an attempt to force the market to behave differently from its natural dictates, so that the sanctity of the pari passu principle is not endangered. Professor Pound had rejected these proposals in his submissions to the Securities Commission during the Lion-Nathan Inquiry.[65] It is submitted that, even if one

looks at the issue from a narrow legal perspective, the principle relied on by the Securities Commission cannot be regarded as providing a universal directive by which all corporate conduct must be guided. It is true, as the Commission says, that the law seeks to ensure that contributors to the corporate funds share in "distributions by the company and in the residual assets of the company" simultaneously and pro rata.[66] It is true also that it is reasonable to give "distributions a broad meaning, that is, to include not only dividends but also any gratuitous payment which is tantamount to gifting the assets of the corporation".[67] However, while generally discouraging distributions that advantage directors or particular shareholders at the expense of the assets of the corporation, the Courts have allowed distributions that satisfy these tests:

"(i) Is the transaction reasonably incidental to the carrying on of the company's business?

(ii) Is it a bona fide transaction? and

(iii) Is it done for the benefit and to promote the prosperity of the company?"[68]

Where a distribution is made shortly before a company goes into liquidation, the Courts have had little difficulty in giving full rein to the pari passu principle because a gift of corporate assets is hardly likely to ensure any lasting benefit for an entity that is moribund.[69] However, where the company is a going concern, the business management rule dictates that so long as the above requirements are met, the Courts should not interfere. This is not to say that the Courts cannot examine the reasonableness of the transaction. As was said by Bowen L.J. in <u>Hutton</u> v. <u>West Cork Railway Co</u>[70]: "Bona fides cannot be the sole test, otherwise you might

have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational." Nevertheless, the Courts have been reluctant to second guess management decisions, while preserving the residual ability to strike down decisions that could not, by any objective criteria, be regarded as for the benefit of the company as a whole.

The board of Lion Corporation thought that an initial purchase from Fay Richwhite at a cash price for which the latter was prepared to sell was the only means by which Lion could achieve a takeover of LD Nathan through the allotment of its own scrip. It thought that there were valuable synergies to be achieved by the merger of the Lion and Nathan business operations. The acquisition of the Fay Richwhite parcel was conditional on the approval of the Lion general meeting. That approval was given. The offer to Nathan shareholders (other than Fay Richwhite) was conditional on 90 per cent acceptances. Nathan shareholders accepted beyond that level, presumably therefore signifying that they too saw advantage in the merger, irrespective of what Fay Richwhite received for its parcel.

Notwithstanding these facts, and while rejecting the suggestion that the pari passu principle be enacted as a legislative norm,[71] the Commission advocated that the principle should govern the nature of statutory controls on takeover bids by the enactment of the proposed measures referred to above. The premise upon which these views were based is that the market requires an "assurance ... that corporate contracts constructed on the pari passu principle will be observed."[72]

Hence, said the Commission:

> "Where the corporate contract requires pari passu distributions, there should be no substantial differences between the contemporary prices of shares ranking pari passu. The monetary value of voting power impounded in the prices of parcels or tranches would be governed by the pari passu requirement. In a takeover situation, there could be a 'premium', representing the value of the potential to increase the profits of the company under a change of control, should attach rateably to all shares that rank pari passu, whether or not those shares are acquired by the new controller."[73]

It is submitted with respect that this analysis ignores the fact that shareholders do not necessarily place equality ahead of a good deal. If that were not so, the Nathan shareholders would have rejected the Lion offer on the grounds that they were not being paid as much as Fay Richwhite.

<u>(c) Matching Legal Machinery and Policy Objectives</u>

How best to enforce laws having a strong public interest component has been much debated by jurists, economists and other social scientists.[74] In New Zealand, the most recent discussion - in the context of anti-trust regulation - is the paper published by the New Zealand Business Roundtable, <u>Antitrust in New Zealand - the Case for Reform</u>.[75] That discussion draws on well-known writings of Posner and others as well as on a lengthy submission[76] by Professor Baxt and Stephen Franks to the Law Commission in relation to its current reference to reform Company Law. That submission, although not directed to takeover laws, contains some interesting observations as to the structure which commercial laws ought to achieve. The authors argue that "the law should be oriented to achievement of objectives ranked in priority". To that end, the law should be "clear, capable

of a fair and strict enforcement, and so enforced.""[77] This view is adopted by the Business Roundtable paper which then however turns away from the certainty that specific, detailed legal rules provide both for judges and for the commercial community in favour of the necessarily vaguer general standard, although supplemented by detailed guidelines (such as those issued by the United States Department of Justice) published from time to time by the appropriate regulatory authorities.[78]

The use of broad, legislative rules or standards, which effectively confer a greater discretion on Courts and other enforcement agencies to meet and deal more effectively with attempts to circumvent the policy objectives upon which the law is based, was rejected on grounds of principle by the Securities Commission in its Report on Insider Trading, made to the Minister for Justice in December 1987.[79] In making recommendations to deal with the problem of insider trading, the Commission said of section 10(b) of the Exchange Act 1934 (U.S.), which makes in unlawful "to use or employ, in connection with the purchase or sale of ... securities ... any manipulative or deceptive device or contrivance in contravention of "rules published by the U.S. Securities and Exchange Commission:

> "We think this is too sweeping for use as a precedent for New Zealand. Under our constitutional tradition, it is regarded as necessary for legislation to designate with precision the mischievous act that is prescribed."[80]

One wonders, if this is so, how section 9 of the Fair Trading Act 1986 ("No person shall in trade engage in conduct that is misleading or deceptive or that is likely to mislead or deceive") was ever enacted.

The point concerned is reminiscent of the debate that occurred in the United Kingdom when the Restrictive

Practices Court was established in 1956. Notwithstanding that the Court was to be composed not only of a High Court Judge but also economic experts, it was felt by many that the legislation - the Restrictive Trade Practices Act - did not define legal rules with sufficient particularity to leave to the Court for determination issues that could be properly regarded as being justiciable. Rather, it was said, the Court was being asked to determine matters of economic policy through the judicial process - a mechanism that, because of its emphasis on adversary procedures, was said to be unlikely to promote the public interest.[81]

Clearly enough, these comments are pertinent to the lack of any precise definition of the criteria which are to guide the Commerce Commission and the High Court in determining whether or not a merger or takeover proposal, if implemented, would result or would be likely to result in a benefit to the public which would outweigh any detriment to the public resulting or likely to result from some person acquiring or strengthening a dominant position in a market.[82] They are equally pertinent to the legislative jumble of contradictory criteria that were thrown into the public interest sections in the earlier 1975 Commerce Act.[83]

It is submitted that, in the area of economic and public policy, the optimum solution is not legislation that is characterised by detailed and highly specific rules that, while having the virtue of apparent centainty, also encourage circumvention by participants in the market or industry and lack the required flexibility to encompass new situations, new problems and new issues not necessarily fully envisaged when the legislation was enacted. Nor is the best solution legislation that is so general and vague that the adjudicating bodies are able to give full rein to their individual idiosyncratic philosophies and prejudices and to current fads in

economic and commercial thinking. Clearly, discretion must be entrusted to the regulatory agencies and to the Courts but, as Professor K.C. Davis has urged in the United States, the discretion should not only be structured but should also be controlled by the publishing of rules and guidelines (as suggested by the Business Roundtable above) as well as by observing the principle of openness in all matters of decision-making and administration.[84]

Equally important is the type of enforcement and adjudicative machinery that is established to adminisiter legislation that is policy-based in the economic and commercial area. It is now generally accepted that High Court Judges, at least sitting unaided by persons having economic or other relevant expertise, and High Court procedures do not provide the best and most efficient means of adjudication of issues arising under such legislation. At the other extreme, decision-making by administrators trained in the ways and attitudes of the Public Service engenders not only concern about the quality of the decisions made but also a high degree of distrust. Hence the development during the twentieth century of specialised administrative tribunals, observing the fundamental principle of hearing parties affected upon which the judicial process is based but adapting rules of evidence, procedure and precedent so as to deal more effectively with the issues before them.[85]

Administrative tribunals have, however, not been an unqualified success. Bodies such as the Commerce Commission which exercise decision-making powers that are determinative of the rights of parties and that affect their commercial interests do sometimes fall into error, either procedural or substantive, and it has been felt necessary to provide rights of appeal to the High Court (in its Administrative Division, sitting with experts) and

to retain the normal powers of review that superior Courts have always exercised in its supervisory jurisdiction over inferior tribunals and administrators. The power of review also extends to bodies such as the Securities Commission, whose powers are almost entirely recommendatory,[86] it being recognised that the inquiries conducted by such a body and the findings and recommendations made by it can adversely affect the interests of parties whose conduct is the subject of inquiry.

There is also a certain unhappiness about bodies such as the Commerce Commission who under the same statute are given enforcement and prosecutorial functions, on the one hand, and judicial functions, on the other. For example, the Commission may take action as plaintiff in the High Court to seek an order requiring the parties to a merger or takeover proposal that has allegedly been implemented in contravention of the Act to make a retrospective application to the Commission for a clearance or authorisation of the proposal.[87] If an order is granted requiring a retrospective clearance to be sought, it is the Commission which then removes its policeman's helmet and puts on its Judge's wig. It is submitted that such a situation is highly unsatisfactory.

III Conclusion

When making submissions to the Securities Commission during the Lion-Nathan Inquiry, Professor Pound summarised the existing regulatory position in New Zealand in the following terms:

"New Zealand stands at a crossroads in the development of its corporate law. It has embarked on a process of broad-based review that could usher in dramatic change. The debate has been spurred in large part by recent

developments in mergers and takeover transactions. These transactions, representing billions of dollars of shareholder wealth, have grown in importance worldwide in the past decade. They have strained the adequacy of existing regulations governing relations between management and various classes of shareholders"[89]

As has been noted at the beginning of this paper, the review of New Zealand commercial laws that is currently underway is taking place in an unhealthy current commercial environment that is unlikely to lead to rational reforms. There are considerable pressures on the Government to be seen to be "doing something" about the unscrupulous and the incompetent (of whom there are certainly many). The danger is however that the reforms will swing too far in favour of "shareholder equity" at the expense of sound economic policy that acknowledges the benefits, both to shareholders as a body and to the economy as a whole, that takeover activity generates.[90] The decision by the Minister for Justice to introduce legislation enacting the principal proposals of the Securities Commission on Company Takeovers justifies these fears.

No one doubts that there is an important need to recognise that those who are entrusted with company assets must observe the fiduciary duties of care and trust that the common law has always required. Although the Courts have never held that controlling shareholders are fiduciaries,[91] they have however been prepared to intervene by imposing equitable limitations (for example, through the doctrine of fraud on a power[92]) on the abuse of the powers of such shareholders where minority interests are being sacrificed to an unacceptable degree. The legal criteria by which the Court does intervene to correct the actions of controlling shareholders are difficult to define. That is not however necessarily to be regarded as a weakness but rather as a strength to the extent the supervisory powers of the Court are thereby

better able to be tailored to meet the facts of any particular case.

It is likely that the Law Commission will seek to strengthen the duties of directors, either generally or in specific situations (notably where there is a takeover bid). Professor Pound argued before the Securities Commission that majority shareholders should be subjected to fiduciary duties as a means of precenting coercion in takeover transactions - for example, by the acquisition of a majority shareholding and then using the voting power accorded to the majority to "squeeze out" or otherwise harm the interests of the minority. That view is however potentially destructive of the traditional principles upon which company law is based and it is submitted that a combination of the equitable limitations which the Courts have imposed on the abuse of power, taken with such statutory remedies as section 209 of the Companies Act that have been enacted specifically for the protection of minority shareholders, is sufficient.

Recognition of the role that the Courts can play in that respect should facilitate the provision of a system of statutory regulation that is better attuned to the correct economic policies. That leaves however the necessity to ensure that the Securities Commission is established as an enforcement agency, equipped with adequate resources to carry out more effectively its functions as a public watch-dog and hopefully in appropriate cases as the initiator of legal action. It would seem essential also that minority shareholders are not dissuaded by high legal costs from taking Court action to remedy oppression and in that respect measures such as class actions and contingency fees must be given serious consideration.

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1. (December 1987): see below

2. (October 1988): Report to the Minister of Justice on *Company Takeovers*

3. Securities Amendment Act 1988

4. *Company Law - Preliminary Paper No.5* (1987)

5. *Loc.cit.*, pp. 52-54, para. 191-199

6. *Malayan Breweries Limited* v. *Lion Corporation Limited*, unreported, May 1988 (Barker J.)

7. Securities Commission Report on *Company Takeovers*, Vol.2, pp.219-220

8. *Op.cit.*, p.219

9. Sharebrokers Amendment Act 1981; *New Zealand Stock Exchange* v. *Listed Companies Association Inc* [1984] NZLR 699 (C.A.)

10. See *City Realties Limited* v. *Securities Commission* [1982] 1 NZLR 74 (C.A.); Lion/Nathan merger (below)

11. Companies Act 1955, s.208

12. [1966] NZLR 122

13. [1908] 2 NZLR 80

14. A "takeover scheme" is defined as meaning "a scheme involving the making of offers for the acquisition of any shares in a company which, together with shares, if any, to which the offeror is already beneficially entitled, carry the right to exercise or control the exercise of more than one-fifth of the voting power at any general meeting of the offeree company": section 2(1).

15. [1983] 1 NZCLC 95-079

16. [1976] 2 NZLR 135

17. In addition, the Act does not apply to offers relating to shares in a private company, where all offerees have consented in writing, before the date of making the offer, to waive the requirements of the Act: section 3(a)

18. Report, *op.cit.*, vol.1, p.139, para A.121

19. *Ibid*, p.139, para.A.119

20. _Ibid_, vol.2, pp.140-141, note B.83

21. See Take-over Code, rules 601-606

22. _Ibid_, rules 607-608 and 611

23. _Ibid_, rules 609-610

24. _Ibid_, rules 612-613

25. See Gross, _Partial Takeovers - A Critique of the Provisions in the Companies (Acquisitions of Shares) Act and Codes_ (1982) 1 CSLJ 251; Coffee, _Partial Justice : Balancing Fairness and Efficiency in the Context of Partial Takeover Offers_ (1985) 3 CSLJ 216; Hockley, _Proposed Australian Regulation of Partial Takeover Bids: When will Shareholders be Adequately Protected_? (1986) 4 CSLJ 105

26. Report, _op.cit._, vol.1, p.2

27. See rule 613(4) for definition of acting "in concert".

28. Rule 613(1)

29. Rule 613(2)

30. See Securities Commission Report, _op.cit._, pp.216-218

31. See Farmer, _Harmonisation of Australian and New Zealand Trade Practices Law after CER_ [1985] R.L. 214, 250

32. Trade Practices Act 1974, s.50

33. See, for example, _TPC_ v. _Australian Meat Holdings Pty Ltd_ (1988) ATPR 40-876

34. Part III, Commerce Act 1986

35. S.50(3)

36. First Schedule to Act

37. Whether or not that person is a participant in or otherwise a party to the proposal : s.66(3)(a)

38. S.66(3)(a) and s.66(6)

39. S.66

40. S.66(9)

41. Discussion Papaer, _Review of the Commerce Act 1986_, August 1988

42. See Securities Commission Report, vol.1, p.171, para. D.6 and Department of Trade and Industry Discussion Paper, Loc.cit., pp.44-49

43. Loc.cit, p.48

44. S.36

45. See Farmer, loc.cit.

46. See, for example, Re QCMA and Defiance Holdings Limited [1976] ATPR 40-012; Broken Hill Pty Co Limited re Koppers Pty Limited [1981] ATPR 40-203. A view shared by the Securities Commission: see Report, op.cit., vol.1, p.173, para D.8

47. Antitrust in New Zealand - The Case for Reform

48. Ibid, p/vii

50. Trade Practices Act 1974, s.52 et seq.; Fair Trading Act 1986, s.9 et seq.

51. (1982) 149 CLR 191

52. Ibid., 205

53. [1986] ATPR 40-702

54. (1987) 3 BCR 257

55. Op.cit., vol 1, pp 172, paras D7-D14

56. Ibid, pp 173-174, para D9

57. Ibid, p 174, para D9 and vol 2, p 169, note D37

58. Ibid, vol 1, p 174, para D10

58a. Ibid, p 75, para 11.2

59. Ibid, section 4, pp 76-95

60. Ibid, pp 83-84: and see pp 87-95

61. Ibid, vol 2, p 4, note (1.1)(f)

62. Ibid, vol 1, p 5, para 1.3

63. Ibid, pp 5-6

64. Ibid, p 6, paras 1.4-1.5

65. See NZCIS Occasional Paper, infra, p.5

66. Loc.cit, vol 1, p 5, para 1.1

67. Loc.cit, p 5, para 1.2 and vol 2, pp 4-10, para 1.3 citing Aspro Limited v. Commissioner of Taxes [1930] NZLR 935 (CA); [1932]AC 683 (PC); Millers (Invercargill) Limited v. Maddams [1973] NZLR 843; [1938] NZLR 490 (CA); Daniels v. Daniels [1978] Ch.406; Shapira, Statutory Protection of Minority Shareholders: Towards the "Squeeze-Out"? in Contemporary Issues in Company Law (1987) ed.Farrar, p 185. And see Parke v. Daily News Limited [1962] Ch.927.

68. Re Lee, Behrens & Co Limited [1932] 2 Ch.46, 51 per Eve J.; cf. Charterbridge Corporation Limited v. Lloyds Bank Limited [1970] Ch.62

69. Parke v. Daily News Limited, supra; Hutton v. West Cork Railway Co(1883) 23 Ch.D 654

70. Ibid, 671

71. Loc.cit, vol 1, p 56, para 7-10

72. Loc.cit, p 76, para 12.2

73. Loc.cit, p 72, para 10.1

74. For one analysis, see Farmer, Tribunals and Government (1974) Weidenfeld and Nicolson, London.

75. (September 1988), Section 6, pp 43-53 (The Economics of Law Design and Enforcement).

76. March 1988 (commissioned by the New Zealand Business Roundtable)

77. Ibid, p 4, para 9.

78. Loc.cit, pp 43-44, para 6.1.1

79. And see now Securities Law Reform Bill which, inter alia, will enact comprehensive reforms in the area of insider trading.

80. Loc.cit, vol 1, pp 38-39, para 4.9.5

81. See Farmer, op.cit, pp 28-33

82. Commerce Act 1986, s.66(8)

83. Commerce Act 1975, ss 2A and 80; and see Farmer, loc.cit, fn 31 above

84. K.C. Davis, Discretionary Justice (1969); Farmer, op.cit, p 197

85. See Franks Committee Report on Administrative Tribunals and Enquiries (1957) Cmnd. 218; Farmer, op.cit, chapter 8

86. See City Realties Limited v. Securities Commission, supra

87. Commerce Act 1986, section 67

88. Ibid, s.83

89. Later published as The Market for Corporate Control, NZCIS Occasional Paper (1988) p.2

90. See Pound, loc.cit, chapter 1

91. See generally Farrar, The Duties of Controlling Shareholders in Contemporary Issues in Company Law (1987), op.cit, p.185

92. See, for example, Ngurli v. McCann(1953) 90 CLR 425, 438-440.

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