New Zealand Shareholders Association Inc.
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Many Investors, One Voice

NZSA Policy No 20 – Takeover and Schemes of Arrangement

Application: This policy applies to all NZX listed companies.

Purpose: NZSA maintains a range of policies to moderate the behaviour of all participants in the NZX listed company sector. These policies should be read in the context of the NZSA Policy Framework Statement.

Statement No 20:

This policy document outlines both the current NZSA position related to the current regulatory environment, as well as the advocacy position to be adopted by NZSA.

This is a new policy for NZSA; there is no predecessor policy document.

1.0 Policy: Takeovers

1.1 This policy is predicated on the **current** regulations associated with takeovers in New Zealand.

1.2 NZSA will continue to advocate for changes to regulations to ensure a 'level playing field' between takeovers implemented via the Takeovers Code (2000) or a Scheme of Arrangement (see section 4.0).

1.3 NZSA prefers to see full or partial takeover offers made under the regulations associated with the Takeovers Code (2000).

1.4 NZSA accepts that under current Takeover Code (2000) regulations, a takeover made under a court-approved Scheme of Arrangement may provide more certainty for investors under some circumstances, including:

a) Where Overseas Investment Office or other regulatory agency approvals are required on behalf of the Offeror, that may extend past the 90 day deadline associated with offers under the Takeovers Code

b) Where proposed payment mechanisms to Target Company shareholders extend beyond "cash and share" arrangements (see example in section 2.7a).

1.5 Regardless of the approach used to facilitate takeovers, NZSA expects that an independent report will be prepared for Independent Directors of the Target Company

on behalf of shareholders to assess valuations implied in any takeover situation (note that this is line with current practice).

1.6 For takeovers implemented via a Scheme of Arrangement, NZSA supports any initiative taken by Target Company Independent Directors to improve their capacity and capability to review offers without duress. Factors that support this may include:

a) Access to both the independent report and the appraiser are controlled by Independent Directors of the Target Company. In the context of a Scheme of Arrangement, the Offeror should **not** be able to access the organisation undertaking the independent appraisal or have any opportunity to influence outcomes.

b) More broadly, the appraiser should not be able to be unduly influenced by anyone who has an interest in the outcome of the transaction (whether from Target, Offeror or other stakeholders).

c) Directors of the Target Company have not extended due diligence rights to any Offeror, until such time as a firm offer has been received (ie, similar to the rights of an Offeror under the Takeovers Code). No Offeror should expect due diligence 'as of right'.

d) Costs associated by the Target Company, including additional director time, are reimbursed by the Offeror.

e) Offerors are bound by confidentiality that prevents a direct approach to media to promote their offer, without the support of the Target Company.

1.7 In line with NZX listing rules, NZSA expects that any takeover interest expressed to the Board that is on terms expected by a 'reasonable person' and have some degree of certainty of proceeding should be disclosed to investors, as per the requirements of section 3.1 of the NZX Listing Rules relating to material information.

1.8 NZSA will not support offers that utilise lock-up agreements or 'break fees' where they disadvantage retail shareholders. This requires assessment on a case-by-case basis, with a clear relationship to the duties of directors in relation to shareholder interest.

2.0 Context

2.1 Regulations associated with Takeovers and Schemes of Arrangements apply to both listed and unlisted companies in New Zealand with 50 or more shareholders. Since January 2020, the Code does not apply to small, unlisted companies with total assets of < $30m and revenue of <$15m. Takeovers form an important 'economic activism' role, in terms of improving corporate performance and recognising under-valued assets.

2.2 The Takeovers Code was introduced in 2000, based on similar Codes in the UK, Australia and Singapore. Its introduction followed pressure from retail shareholders after a series of transactions that had favoured large shareholders in the 1980's – 1990's. An offer

made under the Takeover Code must be accepted by 90% of shareholders before the balance of the shares can be compulsorily acquired.

2.3 Takeover Code offers can also be for a lower percentage of the shares if the Offeror wishes – usually, but not always, this results in a change of control with the company remaining as a listed entity. Offers for lesser share amounts must be made equally (as a proportionate offer) to all shareholders and, in the event of high levels of acceptance, may result in the scaling back of acceptances.

2.4 Schemes of Arrangement (SoA) have been enshrined in Company Law for a long time. They offer a broad functional scope enabling companies to re-organise share capital. A company can use an SoA to create the same outcome as may occur under the Takeover Code. The scheme must be supported by Target Company directors. The threshold for approval under a SoA is:

a) acceptance by 75% of shareholders within the same shareholding class <u>who vote at the Scheme meeting</u> AND

b) acceptance by a <u>minimum</u> of 50% of **total** shareholders AND

c) Court approval to effect the transaction.

d) This means that if 60% of total shares are cast, with 80% of those being in favour, the scheme will not proceed (as total vote in favour are only 48% - less than the 50% threshold). However, if 90% of the votes cast are in favour the scheme will proceed as this represents 54% of total shares.

e) In effect, this represents a de minimis acceptance level of 50% of shareholders, with the outcome then binding on ALL shareholders.

2.5 Since 2014, the Takeovers Panel maintains a monitoring role across SoA's, ensuring equal disclosure to all shareholders and equal treatment of shareholders within the same interest class.

a) An 'interest class' is a grouping of shareholders whose rights are similar and where they are markedly 'dis-similar' to other interest classes, as defined in Schedule 10 of the Companies Act.

b) In practice, this means that a major shareholder in a target who is making a takeover offer via a SoA <u>cannot</u> vote on the transaction in the same class as other shareholders – so a 75% and 50% threshold amongst other shareholders is still required (as outlined in section 2.4)

c) It is worth noting that this same concept does not exist under the Takeovers Code – so the percentage of shares held by an offeror count towards the threshold target.

2.6 An offer under the Takeovers Code is generally controlled by the Offeror engaging directly with shareholders. A takeover effected by a SoA requires the support of the 'target' company to engage with its shareholders. This has the effect of rendering a hostile takeover via an SoA process unachievable.

2.7 There are also limitations to a Takeover made under the Takeovers Code. Specifically,

a) the Takeovers Code envisages payments to Target Company shareholders are made either in cash or shares to shareholders. As was illustrated by the takeover of Westland Dairy Co-op by Yili, which included a long-term supply contract component, this may not always be in the best interests of shareholders. An SoA may offer more flexibility in terms of payment options.

b) there is a time limit of offers and acceptances under the Takeovers Code of 90 days – in practice, this rules out Code offers where Overseas Investment Office (OIO) approval is required.

2.8 In practice, it is more difficult to utilise an SoA to achieve a 'partial' takeover (ie, < 100%), although there have been examples on the NZX (eg, Scott Technology).

3.0 Commentary

3.1 For a 100% takeover, the Takeovers Code acceptance threshold of 90% forms a barrier to an 'Offeror' as compared with the 75% and 50% thresholds associated with takeovers under a SoA.

a) The higher threshold under the Code is associated with the right to compulsorily acquire outstanding shares – an unusually strong power affecting property rights in New Zealand.

b) However, the same occurs with a successful SoA at a lower threshold – if more than 75% of voting shareholders in all interest classes approve a SoA, the result affects ALL shareholders.

3.2 There are other factors that often apply within a Scheme of Arrangement that place greater onus on Directors of the Target Company, compared to the Takeovers Code. These include:

a) costs for an SoA are borne by the Target Company (not the Offeror). Under the Takeovers Code, both directors of the Target Company and the Company itself are entitled to reimbursement of additional costs by the Offeror.

b) an Offeror will often negotiate a period of due diligence as part of its conditions for a SoA, resulting in information asymmetry between the Offeror and shareholders of the Target Company

c) an Offeror will have access to the independent appraiser preparing the independent valuation of the Target Company, creating a real or perceived risk for shareholders as to independence

3.3 NZSA recognises that in Takeovers implemented either via a Scheme of Arrangement or the Takeovers Code, Directors of the Target Company remain subject to continuous disclosure rules, while the Offeror retains the ability to make public statements.

3.4 The nature of passive or index funds means that achieving a 90% target under the Takeovers Code has become extremely difficult, if not impossible, for Offerors.

a) These types of funds are generally not mandated to vote in any form of Takeover, with the scale of passive or index funds such that they often form a shareholding greater than 10% of the Target Company shares.

b) NZSA also notes that every company is likely to have a differing level of investment by passive or index funds, with some smaller companies likely to have no such shareholders.

c) NZSA believes that it is possible for Offerors to structure a Takeover Code offer with a level of acceptances to allow for the presence of index or passive funds, with those funds then mandated to sell as underlying liquidity reduces. However, there is no incentive for Offerors to structure an offer under the Takeovers Code in this manner while it is relatively easy to undertake an SoA.

3.5 A combination of the factors outlined in sections 3.1, 3.2 and 3.3, and the relative certainty of achieving a 100% outcome (with no minority shareholders), has meant that SoA's have become favoured by Offerors in recent years.

3.6 NZSA notes the relative lack of independent research on the relative merits of Takeovers and SoA's.

3.7 NZSA notes that not all takeover approaches have been disclosed to shareholders (for example, Australian Super's engagements with Infratil in late 2020 - early 2021 was disclosed by a major shareholder rather than the company).

a) There is no requirement for an incomplete proposal to be disclosed to shareholders.

b) NZSA recognises that directors of a Target Company remain subject to the continuous disclosure "reasonable person" test, and that whether an offer is disclosed to shareholders is subject the NZX Listing Rules (section 3.1)

3.8 NZSA would expect that all relevant information should be presented to shareholders in the respective offer documents, regardless of method. There should be no requirement or need for third parties to offer additional information that may place undue pressure on shareholders to accept any offer.

3.9 NZSA notes that the appropriateness of lock-up agreements and the negotiation of 'break fees' should be assessed on a case-by-case basis, to ensure they do not unduly disadvantage shareholders.

3.10 NZSA notes that all directors have duties to the company and its shareholders under both Takeovers Code and takeovers implemented via a Scheme of Arrangement.

4.0 Further Advocacy

4.1 The policy statements in Section 1 are predicated on the **current** regulatory requirements. The following advocacy positions represent proposed solutions to redress the imbalance that has developed between takeovers under the Takeovers Code compared with a Scheme of Arrangement.

4.2 In general, NZSA will advocate for solutions that 'level the playing field' between Takeover offers made under the Takeover Code or via a Scheme of Arrangement.

4.3 ***Takeovers Code:*** NZSA will advocate for the following in relation to the Takeovers Code:

a) NZSA believes that Offerors should be incentivised to utilise the Takeovers Code as this has been specifically designed to ensure equitable relationships between all shareholders, Offerors and Target companies.

b) Specifically, NZSA advocacy may include:

i. A move towards alignment of threshold levels for takeovers under the Takeovers Code or SoA's. This may include advocacy for a higher thresholds for takeovers implemented via a Scheme of Arrangement as a primary position (see section 4.4) or alternatively, a lower 'general' threshold level under the Takeovers Code.

ii. A requirement/formula allowing for determination of 'company-specific' threshold levels under the Takeovers Code (to account for the presence of index or passive funds).

b) NZSA will advocate for revisions to the Takeovers Code that preserve the interests of retail shareholders while allowing for more practical processes – including timeline - (to account for the determinations of other regulatory agencies) and payment mechanisms to support the interests of offerors.

c) NZSA will advocate for regulatory agencies (such as the Overseas Investment Office) to respond within a timeframe to support the timing provisions within the Takeovers Code.

e) NZSA notes that the current 90% compulsory acquisition threshold within the Takeovers Code is the same as other major jurisdictions – but that in itself is not a reason to maintain the status quo.

f) NZSA notes the current 'creep' provisions allowed for in the Takeovers Code. We believe that these provisions could act as an incentive for Offerors to effectively structure a Code takeover.

4.4 ***Schemes of Arrangement:*** NZSA believes that consideration should be given by the NZ Government to simplify and increase the threshold limits for a takeover made by a Scheme of Arrangement.

a) Specifically, NZSA advocates for a 75% threshold of total shares within a shareholding class for approval of an SoA transaction (rather than 75% of votes cast and a minimum 50% threshold of total shares).

b) This would 'level the playing field' as compared to an offer under the Takeovers Code and align the threshold requirement with other major transaction resolutions that are put before shareholders from time to time.

c) NZSA also believes that consideration should be given to new rules applying to 'expulsion schemes', applicable where a majority shareholder is implementing a SoA to purchase the interests of minority shareholders.

4.5 ***Proxy solicitation and other direct contact with Target Company shareholders:*** As per section 3.7, NZSA believes that all relevant information should be provided to shareholders. Any additional information provided by proxy solicitors should be treated as an offense and subject to an enforcement regime.

5.0 Key Regulatory Requirements

5.1 Offers made under the Takeovers Code are subject to a 90 day timeline. Offerors are required to lodge a Takeover Notice and then provide an Offer Document to target shareholders. The target company must respond to the offer with a Target Company Statement, recommending or rejecting the offer (supported by an independent valuation report).

5.2 Offers made under an SoA require court approval and a review (not approval) by the Takeovers Panel. The target company will prepare a Scheme Booklet for its shareholders, typically containing similar information to that of a Takeovers Code Offer Document.

6.0 References

Takeovers Panel: https://www.takeovers.govt.nz/

Takeovers Regulations (2000), Companies Act (1993)

NZX Listing Rules, clause 4.9

Minter Ellison Rudd Watts:
Takeover Offer v Scheme of Arrangement – Structuring a friendly acquisition, 29/7/2018

Definitions

Offeror: An entity making an offer for full or partial takeover for a listed or unlisted New Zealand company

Target Company: A New Zealand listed company subject to takeover interest under either the Takeovers Code (2000) or a proposed Scheme of Arrangement that will result in an offering entity owing 100% of the shares.

Related Policies

none

Document Control

This document was approved by the NZSA Board:	**August 11th 2021**
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