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REGULATING THE REGULATORS: A COMPARATIVE ANALYSIS OF TAKEOVER LAW

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Abstract

This dissertation examines takeover regulation in New Zealand, the United Kingdom and the United States of America. It outlines the three systems of regulation before seeking to explain why differences exist between jurisdictions. The paper focuses on the non-frustration rule and self-regulation as two differences which set the systems apart. It evaluates theoretical merits as potential reasons for the divergence in regulatory approaches. Three jurisdiction-specific factors are also cited as reasons for differences in regulation: the competition generated through federalism, the influence of institutional shareholders and political ideology. The paper uses this analysis of the systems and influences on these systems as a platform to suggest reform to the New Zealand regulatory model. The reforms are centered on two parts of takeover regulation: active institutional investment and panel-lead regulation. It advocates for institutional investors to take a more active role in monitoring directors through the creation of a "Stewardship Code". Further, the paper suggests the judiciary should exercise more restraint in its review of the Takeover Panel's decisions. This would help foster commercial certainty as well as the cooperative relationship between the regulator and industry. The purpose of these reforms are to proactively ensure takeover regulation in New Zealand is well-supported and efficient as it faces progressively more commercial activity.

Key words

Takeover regulation, comparative corporate governance, Takeovers Act 1993, Takeovers Panel.

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I Introduction

Corporate takeovers refer to the process of acquiring a majority of the available equity in a target entity. The takeover process provides benefits to the parties involved as well as the economy more generally.[1] It allows the economy to allocate resources more effectively, creates synergy gains for acquiring companies and provides an incentive for management to run their respective companies efficiently.[2]

While these benefits may be apparent, often the takeover process is not a consensual one for all parties to the transaction. The process can often lead to the acquiring entity wishing to make changes not necessarily compatible with the interests or ideas of incumbent directors. Changes that are in the best interests of some shareholders may not correlate with the interests of directors or the target company itself. In addition to this, the interests of all shareholders may not be aligned. Takeover regulation is the mechanism used to ensure all shareholders, directors and bidding companies are dealt with fairly through the bidding process. The balancing of stakeholder rights forms the basis of regulation.

Takeover regulation is an area of corporate law that has been and continues to be subject to significant academic and industry critique. The differences in regulatory approach between jurisdictions has led to academics questioning why such distinctions exist and further, which approach is correct. New Zealand's takeover law, in comparison to larger jurisdictions, is relatively untested. The lack of takeover activity that occurs in a smaller jurisdiction means there is difficulty in suggesting reform based on purely retrospective analysis.

The United Kingdom and the United States of America ('United States') have similarities in commercial landscape and their respective approaches to corporate law.[3] However, amongst such similarities are differences which have led to divergence in how the two jurisdictions approach the regulation of takeover activity. These jurisdictions, by virtue of their economic activity and longevity of regulation, provide useful points of comparison when evaluating New Zealand's regulatory approach.

This paper will look specifically at the United Kingdom and the state of Delaware. The United Kingdom is useful as a comparator as New Zealand derived much of its legal system

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1 D Kershaw *Principles of Takeover Regulation* (Oxford University Press, Oxford, 2009) at 3.

2 William Magnuson "Takeover Regulation in the United States and Europe: An Institutional Approach" (2009) 21 Pace Int'l L. Rev. 205 at 207.

3 As above at 205.

from this jurisdiction. Likewise, Delaware is a deliberate focus due to the federal structure of the United States. Delaware has experienced significant success in attracting companies.[4] The large proportion of companies choosing to incorporate in the state has meant Delaware's state law is largely representative of the United States takeover approach.

This paper seeks to address two main questions facing takeover regulation in New Zealand. The first question is why takeover regulation has developed in a way that is similar to the United Kingdom and very different to the approach of Delaware. The paper identifies two themes which may explain why New Zealand's approach to takeover regulation has exists in the format it does. The first of these themes are the inherent advantages and disadvantages of self-regulation and the non-frustration rule. Secondly, the paper assesses jurisdiction-specific reasons for differences in regulation. These reasons include the competition created from federalism, the influence of institutional investors and underlying ideological factors.

The second question is one of law reform. Having evaluated these differences, the paper takes a cursory look at regulatory reform in New Zealand. This is not suggested due to any inadequacy on the current New Zealand system in how it regulates takeover activity. Instead, this paper posits New Zealand should implement minor reforms based on lessons learnt in the United Kingdom and United States to proactively improve regulation.

This paper suggests reform to make the non-frustration rule more effective in New Zealand. This can be done by replicating the United Kingdom's attempts engage institutional investors through a "Stewardship Code". Secondly, through analysis of procedural regulation across the three jurisdictions, the paper recommends the judiciary take a more light-handed approach in overseeing regulation. This would reduce the potential for problems seen in the United States to occur in New Zealand.

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4 James D. Cox "How Delaware Law Can Support Better Corporate Governance" in F. Scott Kieff and Troy A. Paredes *Perspectives on Corporate Governance* (Oxford University Press, Oxford, 2010) 335 at 336.

II Systems of Regulation

The first part of any comparative exercise is establishing what the legal frameworks are in which jurisdictions currently regulate. By understanding how New Zealand, the United Kingdom and the United States have formed their regulatory systems it serves two purposes. Firstly, to begin to identify what historical problems have occurred so they are not repeated in any attempt at reform. Secondly, to understand the regulatory trajectory in the different jurisdictions. This trajectory refers to regulation becoming either more onerous or alternatively taking a laissez-faire approach. By understanding regulatory movements within each of the jurisdictions it assists the analysis why such regulation exists as it does and how it may change.

A Why the need for takeover regulation?

Through regulation, the legislators attempt to provide a solution to an economic or legal problem. But before turning to these solutions, it is important to recognise what the problem actually is. If the problems related to takeovers are unanimous across all three jurisdictions, it begs the question of why solutions have been different. Corporate takeovers could still exist in a hypothetical where regulation does not, so the first issue is what economic problems exist in the absence of regulation. Such problems can be created by the takeover process itself, or may be created in the absence of takeover activity.

The second type of "problem" is not substantive but rather procedural. While the first issue concerns why takeovers ought to be regulated, the second type asks why supplementary legislation is required to do this. In New Zealand, there is corporate governance legislation that exists to regulate a wide range of company activity.[5]

1 Market for Corporate Control

Takeover regulation helps facilitate the market for corporate control.[6] The market for corporate control refers to the buying and selling of corporations.[7] Within this market, there is competition between potential acquirers and the incumbent owner for control of companies. If a potential acquirer believes that they can increase the value of their business through taking over the target company it will prompt them to launch a takeover bid. The

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5 New Zealand's corporate governance regulatory framework includes statutes such as the Companies Law Act 1993, Financial Reporting Act 2013, Trustee Company Management Act 1975 among others.

6 Andrew P. Dickerson, Heather D. Gibson and Euclid Tsakalotos "Takeover risk and the market for corporate control: the experience of British firms in the 1970s and 1980s" (2002) 20 IJIO 1167 at 1172.

7 Kershaw, above n 1, at 1.

increase in value can be attributed to two theoretical basis: underperforming targets or synergy gains.

If a target company's underperformance is due to fault on the part of management or directors this will encourage acquirers to make a takeover bid. Market competition pressures directors and management to work effectively due to the risk they may be replaced if they do not.[8] If directors underperform in their role, the share price is likely to decrease which will represent a more enticing target for acquirers. Likewise, if these directors are acting in a self-servient manner then this will be reflected in a lower share price.[9] If effective, the market for corporate control will act as a governance mechanism.

This theoretical view has attracted wide academic support however the control mechanism may be limited by transactional costs. If the cost of a successful takeover bid and consequent acquisition is more expensive than the agency costs of poor management the acquirer will not make such a bid.[10] However, the threat of a control mechanism is more effective than actual takeover bids alone. If directors are just concerned about hostile takeover bids then this will have an incentivising effect.

The second theoretical basis referred to are synergy gains. Synergy gains are the result of economies of scale which are created from a company increasing in size. If an acquirer is able to increase its revenue significantly and restrict increases in costs to a lower level then this will form motivation for a takeover bid. Empirical evidence is conflicted around the extent to which synergy gains do in fact materialise or at least to the extent they are forecasted. However these gains continue to be a motivation for takeover bids.

Contrary to directors' underperformance leading to a reduced share price and greater takeover threat, the opposite may also apply. If a company is well-managed, with highly competent directors, it will also be very attractive to bidders looking to capitalise on synergy gains. If the company is poorly directed it may be seen as beyond the point of recovery by potential acquirers even with a reduced share price.

The private sector operating productively is likely to align with government policy, this must be balanced against other issues such as competition regulation. The monopolisation

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8 Andrew Johnston "Takeover regulation: Historical and theoretical perspectives on the city code" (2007) 66(2) CLJ 422 at 431.

9 Kershaw, above n 1, at 16.

10 John Coffee "Regulating The Market for Corporate Control: A Critical Assessment of The Tender Offer's Role in Corporate Governance" (1984) 84 Colum. L. Rev. 1145 at 1200.

of certain industries for the purpose of achieving economies of scale or removing ineffective management may be countered by concerns that companies in the industry will act in an inefficient way once they achieve their position.

While these management incentives and synergy gains present an opportunity for all three jurisdictions, there is arguably a need for regulation to ensure the process is conducted in a way which is fair to parties. The benefits stemming from the market for corporate control can be circumvented if the directors put measures in place to prevent themselves being replaced. If these measures are successful it will prevent incumbent shareholders from accessing value and compensation from potential acquirers. Hence, prioritising the welfare of shareholders over directors forms the first ground for regulation.

2 Shareholder Protection

The market for corporate control also can expose minority shareholders to economic disadvantage during the takeover process. In an unregulated market, gaining control over a company does not require the acquirer to treat shareholders equally. An acquirer will be able to pay particular shareholders a premium for the private benefit of control connected with their shares and not others. In theory, a lack of regulation compelling a bidder to offer the same terms to all shareholders will increase takeover activity.[11]

However, the premium paid to the shareholders who are first to yield their private control benefits will have the effect of depriving other shareholders of any control premium. This will mean that they receive less compensation for their equity than the market price would suggest. By allowing investors to be treated differently, it may also lead to the diminution in shareholders ability to seek a higher price from bidders.[12] Shareholders may be concerned they will lose substantial value if their fellow-shareholders receive a better price. This can lead to shareholders being incentivised to accept a lower offer price. These regulatory concerns were illuminated in the 1988 Securities Commission Report in New Zealand which adopted the pari passu principle – that shareholders ought to be treated equally.[13] Ensuring that shareholders are treated equally through the process continues to be an ongoing regulatory priority for takeovers.

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11 Victor Brudney “Equal Treatment of Shareholders in Corporate Distributions and Reorganizations” 71 Cal. L. Rev. 1072 at 1119.

12 At 1120.

13 Securities Commission *Company Takeovers: Report to the Minister of Justice by the Securities Commission, Volume 1* (1988)”] at 23.

3 Investor Confidence

Investor confidence is closely interrelated with regulatory goals of equal treatment and market efficiency. While not a final objective in itself, strong investor confidence in a regulatory scheme is likely to increase the level of investment. Investment from domestic and international sources is a regulatory goal for governments. This is particularly important in countries such as New Zealand which are heavily reliant on foreign entities providing financial investment to grow the economy.[14] This confidence can stem from a number of sources outside the scope of takeover regulation such as the general performance of a jurisdiction's economy and its level of infrastructure. However, a regulatory scheme which contains a functioning dispute resolution process and treats shareholders fairly is also likely to play a role in such confidence.

All these substantive economic reasons for regulation are the same across the United States, the United Kingdom and New Zealand. At first glance, it is then remarkable as to why these jurisdictions have adopted such different approaches to address the same concerns for shareholders, potential investors and ensuring economic efficiency.

4 Supplementary Regulation

There are different requirements for supplementary regulation specific to corporate takeovers. The first of these requirements is ensuring the directors have sufficient pressure to perform their role to a high standard and prioritise the company over their own interests. The second involves regulating to ensure shareholders are entitled to certain rights during the takeover process so none are unduly disadvantaged. Finally, there is the procedural regulatory requirement of creating a functional, standardised takeover process to entice investment.

There is existing regulation specifying how directors are to act in their roles. Directors and managers are regulated more broadly through corporate governance statutes, notably the Companies Act 1993.[15] The Act sets out a set of directors' duties which can be broadly classified into care, diligence and skill as well as loyalty and good faith.[16] In theory, these duties would suffice in addressing the regulatory requirements. The statutory duty to act with care, diligence and skill as per s 137 would mean that directors are already required to perform to a high standard and competitive pressure will not have any additional

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14 Steven Joyce *New Zealand Investment Attraction Strategy* (Minister of Economic Development, 2014) at 1.

15 Companies Act 1993.

16 J Farrar *Corporate Governance in Australia and New Zealand* (Oxford University Press, Melbourne, 2001) at 103.

influence.[17] Further, the obligation to act in the best interests of the company would suggest that directors are not legally allowed to act in a way that succumbs to the agency problem.[18]

In practice, takeover-specific regulation exists in all three jurisdictions. This suggests that broad director duties are insufficient. Supplementary regulation has been introduced because during a takeover bid, directors are placed in a direct conflict of interest. Further, many of the statutory duties are broad enough that dubiously inefficient behaviour on the part of a director may be not be disincentivised. This is supported by the long title in the Company Act was expressly stated directors were able to use "wide discretion in matters of business judgment".[19]

Investor confidence and the interests of shareholders throughout the takeover process are not served by existing company law legislation. The mechanism by which the takeover process is controlled to protect stakeholders and provide a robust resolution process is independent from any other legislation. Regulation such as a code or court precedent consequently performs more than a supplementary role with the takeover process.

B The New Zealand System

The current takeover regulation framework in New Zealand was created more recently than the United Kingdom or the United States equivalent. It consists of a dedicated quasi-regulatory body, specific takeover legislation as well as more general corporate governance legislation. While the framework is substantive, there are many aspects of the regulation that have not been tested. This is due to the cooperative approach taken by the regulatory body as well as the comparatively small market for corporate control which generates less takeover transactions. Prior to understanding the reasoning behind international differences or seeking to reform a system, it is important to outline what the system is in its present state vis-à-vis the United States or the United Kingdom.

1 Pre-1990s Regulation

Prior to the Takeover Act in 1993, takeover activity in New Zealand was regulated through the Companies Act 1955 and later the Companies Amendment Act 1963.[20] The 1955 legislation provided only basic regulation specific to takeovers. Section 208 legislated if an acquirer owned 90% of the share capital they were able to compel the minority

17 Companies Act 1993, s 137.
18 Companies Act 1993, s 131.
19 Companies Act 1993, long title.
20 Companies Act 1995 and Companies Amendment Act 1963.

shareholder to sell their shares on the same terms as other shareholders.[21] This provision was consistent with the United States and United Kingdom regulations allowing what was described as "squeeze-outs". The Companies Act 1955 also introduced a provision requiring directors to declare a conflict of interest.[22] Theoretically, this conflict could extend to the event of a takeover bid where a director's position would be put in jeopardy. However, there was no further legislative guidance on how to manage such a conflict of interest, much less what was to happen in the event of a takeover bid.

More prescriptive regulation came into place with the Companies Amendment Act 1963.[23] This legislation was introduced specifically for the purpose of regulating takeover activity. The Act produced requirements around providing offer and response documents within a set time frame. The offer and response disclosure formed the basis for what is required presently as per the Takeovers Code.[24] The purpose of these requirements were to provide shareholders with the time and information required to make an informed offer.[25] This was a disclosure-based approach to regulation whereby shareholders would be expected to make an economically rational decision if provided with the required information. During the passing of the Act, the then Minister of Justice acknowledged there had been no major issues in New Zealand up until that time with regards to takeover regulation[26]. The Act was a response to what was seen in other jurisdictions, namely the emergence of the hostile takeover in the United Kingdom.[27]

In 1988 the Securities Commission produced a report suggesting that new disclosure law was required.[28] The recommendations were based on two objectives. Firstly, to ensure the observance of corporate contracts so that shareholders were treated equally.[29] Secondly, to improve the takeover procedure with a goal of allocating resources more efficiently.[30] These objectives led to the recommendation of a mandatory bid rule, a more comprehensive takeover process relating to the time period and the establishment of an administrative authority.[31]

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21 Companies Act 1955, s 208
22 Companies Act 1955, s 199.
23 Companies Amendment Act 1963.
24 Schedule 2; Takeovers Code 2001.
25 Section 8; Schedule 2.
26 (24 September 1963) 336 NZPD 2017.
27 Andrew Johnston, above n 8, at 427.
28 As above, n 8.
29 Securities Commission, above n 13, at 76
30 At 76.
31 At 83-84.

This report coincided with the Lion Breweries Limited transaction which caused major controversy.[32] Lion Corporation at the time was able to gain control of L.D. Nathan by paying one shareholder 67% more than other shareholders.[33] This wide deviation from the pari passu principle lead to investors calling for reform. For the purpose of protecting its international reputation and responding to the Securities Commission report, the New Zealand government sought to introduce new regulation.

2 The Takeovers Act

In 1993, the Takeovers Act and the Companies Act were introduced.[34] Sir Douglas Graham, the then Minister of Justice, described the existing legislation as "out of date and largely ineffective" following incidents such as Lion Breweries.[35] These two pieces of legislation form the current statutory background for takeover regulation. The Companies Act 1993 set out broad duties that directors must comply with at all times such as exercising a professional level of care and skill as well as acting in the best interests of the company.[36] The Takeovers Act also provided rules regarding specific corporate transactions. The Takeovers Act established the administrative body responsible for regulating transactions, the Takeovers Panel.[37]

The creation of the Takeovers Panel as a Crown Entity reflected an initial foray into the self-regulatory approach of the United Kingdom. However, the New Zealand Panel was more embedded as a government agency in contrast with the independent nature of the United Kingdom's Panel. This was also tempered with the judiciary's ability to review both decisions made as well as support the Panel in enforcing its determinations. The Panel falls within the executive branch of government and is part of the Ministry of Commerce and Consumer Affairs. Broadly, the legislation meant the Panel was responsible for investigating and enforcing against any contravention of takeover regulations as well as recommending any areas of law reform.[38] The Panel was to be led by a Chairperson and Deputy appointed on the advice of the Minister of Commerce.[39] Along with these two positions, the Panel was to be made up of experts from the legal, business or accounting

32 D M Grant *Bulls, Bears and Elephants: A History of the New Zealand Stock Exchange* (Victoria University Press, Wellington, 1997) at 350.
33 At 350.
34 Takeovers Act 1993; Companies Act 1993.
35 (1993) 553 NZPD.
36 Companies Act 1993, ss 137 and 131.
37 Takeovers Act 1993, pt. 2.
38 Takeovers Act 1993, pt. 1.
39 Section 6(2).

professions.[40] The Act granted the Panel certain powers of enforcement and established basic prohibitions against false and misleading statements.[41]

3 Contemporary Developments

The legislation allowed the newly founded Takeover Panel to work with the Government in establishing a Takeovers Code which would set out the rules for takeovers. The purpose of a Takeovers Code, as per s 20 of the Act, was to ensure the efficient allocation of resources and encouraging competition for control.[42] However, the third objective was to ensure there were sufficient protections in place so shareholders were treated fairly throughout the process. These competing interests set the foundations for the Code which was enacted almost a decade later.

The Takeovers Code was established in 2000 and implemented a year later following recommendations from the Takeovers Panel.[43] The rules contained would only apply to "code companies" which were defined as those who were currently listed or had been in the last twelve months, and those who had more than 50 shareholders or shares.[44] The Code was based on a fundamental rule that if an entity planned to acquire more than 20% of a code company's share capital they had to do so in a regulated way. This regulated process was based on the Companies Amendment Act 1963 and involved giving shareholders sufficient time and information to allow them to make an informed decision.[45]

The Code implemented several key provisions which set New Zealand apart from some other jurisdictions. Firstly, the mandatory bid rule was established.[46] This meant that for any takeover offer, bidders were required to offer all shareholders the same consideration and terms when making a bid for shares of the same class. In addition to this, if more shareholders accepted the price than there were shares sought after, the bidder had to scale down the share transactions to treat each shareholder evenly. The Code also introduced a non-frustration rule in prohibiting defensive tactics.[47] These changes to the regulatory framework were met with opposition from groups such as the New Zealand Business

40 Takeovers Act, s 6(4).
41 Section 44B.
42 Section 20.
43 Takeovers Code 2001.
44 Takeovers Act 1993, s 2A.
45 Takeovers Panel "Code Word: No. 1" (February 2001) < http://www.takeovers.govt.nz/assets/Assets-2/Code-Words/code-word-01.pdf>.
46 Takeovers Code, r 20.
47 Takeovers Code 2001, r 38.

Roundtable.[48] Groups such as this opposed the introduction of some of the regulation due to the predicted increase in transaction costs. With more intensive compliance costs associated with takeovers there were concerns about efficiencies in the market for corporate control and how that might deter international investment.[49]

Since the Code was introduced in 2001 there have been no major changes to New Zealand's regulatory landscape. The regulatory framework that has developed since 1955 is one that has steadily moved in a interventionalist direction. Regulation has moved in a trend of requiring greater disclosure, placing greater restrictions on how parties to the transaction can act and providing more resources to regulate the industry. However since 2001, legislative reform to the regulatory framework have been minimal and in the form of intermittent publications from the Panel.[50]

When the development of the New Zealand system is analysed holistically it appears that reform has largely been reactive. When it is clear there have been abuses in the takeover process domestically, reform will follow. While it is important for reform to address the particular requirements of the jurisdiction at the time, it is also vital that it is forward-focussed. By analysing more mature systems found in the United Kingdom and the United States, reform can be proactively introduced, to the benefit of New Zealand regulation in the future.

C The United Kingdom System

The United Kingdom's system of takeover regulation offers the first point of comparison to its New Zealand equivalent. Similarly to New Zealand, it is prescriptive in terms of substantive regulation but the process by which the regulation is enforced can be seen as "softer" than the United States. The way in which the United Kingdom established their takeover regulation is particularly important as the jurisdiction is responsible for much of the law that exists in New Zealand today. As an ex-colony of the United Kingdom, it is arguable that a path dependency has occurred with New Zealand's approach. This is where New Zealand would follow the United Kingdom's approach out of historical habit. The formation of regulation in the United Kingdom is, at least to some degree, a part of New Zealand's regulatory formation as well.

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48 New Zealand Business Roundtable "Submission to the Takeovers Panel on the June 2000 Draft Takeovers Code".
49 As above at [2.1].
50 Takeovers Panel "Code Word" (March 2018) Takeovers Panel <http://www.takeovers.govt.nz/guidance/code-word-3/>.

1 Pre-Code Regulation

Hostile takeovers emerged in the United Kingdom in the 1950s. This emergence was caused by new financial disclosure requirements, increases in taxation and consumption resulting in a market for corporate control.[51] Shares were largely undervalued due to a lack of asset revaluations and as a result institutional investors were willing to sell them at a premium.[52] The rise of hostile takeovers was met with a "boardroom revolution". Directors at first tried to protect their positions through increasing dividends but then resorted to defensive tactics. The most drastic of these defensive tactics came with the Savoy Hotel affair where directors placed assets outside the control of shareholders in order to protect their position.[53] There was legal uncertainty over what directors were able to do and until 1959 the only regulation came in the form of the Bank of England discouraging lending for takeover bids.[54]

In 1959, the market regulators responded through the Governor of the Bank of England convening a conference with a goal of creating a code of conduct.[55] From this conference, the Bank published "Notes on Amalgamations" which set out the framework for what would develop into the City Code.[56] This document was based on the notion of shareholder primacy, under which shareholders ought to be the ones responsible for deciding whether to accept a takeover bid. The Notes also set out basic disclosure and timing requirements for the takeover process.[57] The disclosure-based regulatory approach alongside shareholder primacy, are two important concepts which have dominated the United Kingdom's takeover regulation system and are also found in New Zealand.

2 The City Code and Panel

In 1968 the City Code came into effect along with a Panel to act as the administrative body. The Code itself is made up of six general principles as well as a series of rules. The use of principles allows the Panel to act flexibly when enforcing compliance with the Code. The key rules contained in the Code include prohibitions around the use of defensive tactics and a mandatory bid rule. This also built on the Amalgamated Notes' approach in providing a procedure that had to be followed involving disclosure and time-frame regulations.

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51 Richard Roberts "Regulatory Responses to the Rise of the Market for Corporate Control in Britain in the 1950s" (1992) 34 Business History 183.
52 R W Moon *Business Mergers and Takeover Bids* (3rd ed., Gee, London) at 125.
53 Johnston, as above n 8, at 429.
54 At 431.
55 At 432.
56 At 432.
57 Johnston, as above n 8, at 433.

The Panel is similar to New Zealand in that it is made up of an executive along with appointed members who are experts in commercial and legal fields. However, the Panel's main difference is the separation of the Hearings Committee from the Code Committee.[58] The Hearings Committee is responsible for deciding whether the Code has been breached.[59] The Code Committee is the rule-making body of the Panel who make revisions and amendments to the City Code.[60] The separation of these two bodies was designed to stop the Panel carrying out legislative as well as judicial functions and consequently acting arbitrarily.

The Panel enforced its decisions through reliance on the goodwill of code companies.[61] If companies refused to comply with decisions made by the Panel then there was an understanding that they would be excluded from the business community. This system of goodwill was supported by a threat of government intervention if such goodwill was to fail.[62] To date, the use of goodwill as a regulatory mechanism has been effective, evidenced by the fact that the Panel has only needed to exclude entities twice.[63]

The self-regulatory approach was independent of any government or judicial oversight until 1986. In the landmark *Datafin* decision, the United Kingdom Court of Appeal held that the Panel would be subject to judicial review.[64] This was on the basis that the Panel was exercising public functions despite the powers of the Panel not being sourced from a statutory instrument.[65] There was initially significant concern around the implications of this decision. Prior to *Datafin*, the Panel and the Code were renowned for their flexible and efficient approach.[66] The industry was worried that providing parties with the ability to appeal and question the Panel's application of the code would lead to an erosion of the flexible approach and delay proceedings due to tactical litigation.

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58 The Takeover Panel " Panel Membership" (2018) The Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/panel-membership>.
59 The Takeover Panel "Hearings Committee" (2018) The Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/committees/hearings-committee>.
60 The Takeover Panel "Code Committee" (2018) The Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/committees/code-committee>.
61 John Armour and David A. Skeel Jr "Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation" (2007) 95 Geo.L.J. 1787.
62 At 1794.
63 Michael Craine QC *Ruling of the Hearings Committee* (Chairman of the Hearings Committee of The Takeover Panel, 2017) at 21.
64 *R (Datafin plc) v Panel on Take-overs and Mergers* [1986] QB 815 at [7].
65 At [29].
66 Paul Davies QC "Enforcing the Takeover Panel's Decisions: Panel v King [2018] CSIH 30" (25 June 2018) <https://www.law.ox.ac.uk/research-subject-groups/commercial-law-centre/blog/2018/06/enforcing-takeover-panels-decisions-panel>.

3 Takeover Directive and Contemporary Developments

In 2004, the European Union Takeover Bids Directive ('Takeover Directive') was introduced.[67] As a member of the European Union, the United Kingdom was required to ensure the rules contained in the Directive were reflected in domestic legislation. The Directive harmonised regulation around mandatory bids and disclosure requirements with a goal of providing greater certainty for cross-border takeover bids and to provide equal protection to companies of member states.[68] While these two rules became compulsory, regulation around breakthrough rules and defensive tactics was less definitive. The 'Portuguese Compromise' meant that several major articles would have opt-out provisions for member states.[69] This compromise played a part in the heavily political process that involved balancing member state autonomy alongside standardisation of regulation.

In practice, the Directive was largely based on the United Kingdom system of regulation and due to numerous opt-out provisions, there was no major impact on existing regulation. The significant change came in the actual implementation of the Directive. In order to bring the Directive into effect in the United Kingdom, the government was required to pass the Companies Act 2006.[70] As a result of the Act, the Panel now formally derived many of its powers from a statutory instrument.[71] Similar to the *Datafin* response, critics of the Directive saw the legislation as a threat to the flexible, self-regulatory approach that had been used until that point. There were concerns about the lack of protection in the Directive from issues such as tactical litigation and this would lead to the regulatory system becoming less effective.[72]

The influence of the Takeover Directive is now in a state of flux. The United Kingdom invoked Article 50 of the Treaty of Lisbon which began the process of the state's withdrawal from the European Union.[73] As withdrawal negotiations are ongoing at the time of writing, it is unclear if the agreement will maintain any obligations the Takeover Panel has adopted to maintain consistency with the rest of the European Union. If the free-flow

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67 Directive 2004/25 on takeover bids [2004] L142/12.
68 Christophe Clerc and others *A Legal and Economic Assessment of European Takeover Regulation* (Marccus Partners and Centre for European Policy Studies, 2012) at ii; Malin Hamnered "The Takeover Directive – and Its Implementation in Germany, UK and Sweden" (LLM thesis, Lund University) at 19.
69 Clerc, above n 68, at 1.
70 Directive 2004/25 on takeover bids [2004] L142/12.
71 Barbara Muston "Coping with Change: A View from the UK Takeover Panel" in John Munch and Rolf Skog (eds), *The Securities Council 25 Years – An Anthology* (Capital Markets Board, Stockholm, 2011).
72 As above n 71.
73 European Union (Notice of Withdrawal) Act 2017 (UK).

of capital is not included in any withdrawal agreement then it is unlikely the United Kingdom will be bound by the international law relating to takeover regulation.

Much like New Zealand, the United Kingdom has increased the level of scrutiny and government oversight in the regulation of takeovers since the framework was established in the 1960s. The self-regulating origins of the regulation has meant that the United Kingdom regulatory scheme continues to enjoy the benefits of flexibility and efficiency, despite legislative and judicial action to curb such origins. These benefits also exist in spite of the British Code being more prescriptive that its New Zealand equivalent. Further, the United Kingdom has elected to separate the judicial and rule-making functions of the administrative body. These differences, and the reasons for them, provide suggestions of law reform.

D The United States System

An understanding of the United States system provides another valuable point of comparison to assess New Zealand's regulation. The United States regulatory framework is significantly different to that of the United Kingdom or New Zealand. Regulation in the United States is less prescriptive in limiting what parties can do. It is also regulated more formally, namely through the judiciary rather than independent agencies. As the first part of the paper addressed, systematic differences are remarkable considering the United States' objectives for regulation largely mirror those of New Zealand or the United Kingdom. An outline of the functional regulatory framework in the United States posits the question of why the New Zealand system has chosen to align more closely the United Kingdom version.

Takeover regulation in the United States stems from federal and state legislation as well as common law decisions. The federal system of governance in the United States means that there are certain distinctions in regulation between states. While the federal government has overarching authority across all the sub-jurisdictions, state governments and judiciaries are permitted to deviate slightly within existing federal law. For the purposes of this paper, analysis will centre on the state of Delaware. Currently over 66% of the Fortune 500 Companies are incorporated in this state.[74] The volume of corporate governance litigation that has occurred in this state has generated a large amount of regulation stemming from judicial decisions.

74 Delaware Division of Corporations "About the Division of Corporations" Delaware.gov < https://corp.delaware.gov/aboutagency/>.

1 Federal Regulation

Contemporary federal takeover regulation originated with the Williams Act in 1968.[75] The legislation was the result of the SEC's call for regulation in order to protect investors.[76] The Act was centred on a disclosure-based system of regulation and was designed to provide sufficient information to shareholders to allow them to decide whether to accept a takeover bid. The Act required the bidder to provide certain information about the offer such as the purpose of acquisition and their source of funds.[77]

The Williams Act provided the Securities Exchange Commission (SEC) with some regulatory authority to oversee that the takeover process was followed. The SEC was created in 1934 with a purpose of raising investor confidence in the United States.[78] Rather than being a semi-judicial body itself, the SEC enforces regulations through bringing lawsuits against organisations who do not comply with the necessary disclosure obligations.

Unlike the United Kingdom or New Zealand's respective Panels, it has a wider host of responsibilities than just takeover activity. However, specifically to takeovers, the SEC's role is more limited. Responsibility is shared between the agency and the judiciary. The SEC takes responsibility for oversight of the disclosure regulations while the courts have taken responsibility in regulating how an incumbent board responds to a bid.[79]

2 State Antitakeover Statutes

Between the 1960s and 1980s, there was a significant increase in state regulation of takeovers. State legislatures were given wide-scope to introduce statutes enabling defensive tactics. In Delaware, this is referred to as the Delaware General Corporation Law.[80] These anti-takeover statutes are designed to protect certain companies within their jurisdiction from hostile bids.[81] The legislation enacted can be divided into two categories: anti-takeover statutes and defensive device statutes.

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75 Williams Act 1968 (US).

76 Henry R. Daar "Expansion of the Williams Act: Tender Offer Regulation for Non-Conventional Purchases" (1980) 11 Loy. U. Chi. L.J. 277 at 280.

77 Williams Act 1968, ss 13 and 14.

78 Securities Exchange Commission "What we do: Creation of the SEC" U.S. Securities and Exchange Commission <https://www.sec.gov/Article/whatwedo.html>.

79 Magnuson, above n 2, at 213.

80 Delaware General Corporation Law (State of Delaware) 2018.

81 Magnusson, above n 2, at 216.

Anti-takeover statutes included "control share" acquisitions as well as "fair price" statutes. The latter type of statute can be described as a variation of the mandatory bid rule present in the United Kingdom and New Zealand. States were given wide scope to enact such legislation. In *CTS Corp. v Dynamics Corp.* the United States Supreme Court held that these statutes were permissible as long as the bidder was able to make a bid in line with federal law and didn't discriminate between bidding entities.[82]

Defensive device statutes were also enacted authorising boards to include defensive tactics in their constitution. Statutes used included allowing staggered boards to operate and implemented dual-class shares designed to require supermajority voting. Both of these had the result of making hostile takeovers more difficult in practice. These statutes, in contrast to legislation in New Zealand or the United Kingdom had the effect of allowing boards to decide whether or not to implement measures frustrating takeover bids.

3 Courts of Delaware

Anti-takeover statutes while important, do not form the central regulatory system originating from state jurisdictions. The Courts of Delaware and other states perform two functions. Firstly, they are the primary dispute resolution body when shareholders or bidding entities believe the directors have acted illegally. Secondly, the decisions from the Courts form regulatory rules themselves.

The major addition to takeover regulation from the Delaware judiciary was in determining what directors were able to do when faced with the hostile bid. In deciding whether actions were legal, courts balanced directors' fiduciary duties of loyalty with a presumption that directors had acted in the best interests of a company.[83] This began with the *Unical Corp. v Mesa Petroleum Co.* decision.[84] Here, the Supreme Court established a two-part test in establishing whether directors had acted legitimately. The directors needed to demonstrate the takeover bid represented a danger to corporate policy.[85] Following this, they had to establish the defensive measure was a reasonable response to the danger posed.[86] What was regarded as reasonable was given wide scope in *Unitrin* where the court established a measure would be reasonable as long as it was not draconian.[87]

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82 *CTS Corp. v Dynamics Corp.* 481 U.S. 69 (1987).

83 Celia Taylor "The European Takeover Directive: A US Comparison" (Working Paper 16-33, Legal Research Series Papers, University of Denver) at 61.

84 *Unocal Corp. v Mesa Petroleum* 493 A.2d 946 (1985).

85 At 954-955.

86 *Unocal Corp. v Mesa Petroleum*, above n 84, at 954-955.

87 *Unitrin Inc. v American General Corp* 651 A.2d 1361 (Del. 1995).

This wide degree of discretion and director-primacy created by the courts reflects the influence of state judiciaries in formulating takeover regulations. The use of the judiciary as a rule-making and regulatory body distinguishes the United States approach from New Zealand or the United Kingdom, where this role is mainly performed by the respective Takeover Panels.

Between federal and state regulation, the United States has developed a laissez-faire approach to supervising takeovers. While there are less obligations on the offeror throughout the bidding process, target company directors are given wider scope to respond in kind. This approach sets the United States apart from the other two jurisdictions both in style and substance. Whether these differences are the result of policy-makers coming to different conclusions on the inherent merits of the systems or whether this is a consequence of country-specific reasons is now analysed.

III Differences in Regulation

With an understanding of the three systems, the purpose of this paper turns to analysing what sets the three apart. This section focuses on outlining two distinctions between the systems and evaluating the merits of different approaches. Evaluating these merits begins to answer the question of why the jurisdictions have taken different approaches. The use of theoretical and practical evidence critiquing the various positions helps clarify reasons for the differences.

Once the reasons for positions are clarified, it allows the paper to analyse New Zealand's approach in the contemplation of law reform. It is important to question the degree to which these theoretical reasons have influenced regulation policy in New Zealand, in contrast with the jurisdictional factors referred to in part four of the paper.

A Non-Frustration Rule

Substantive distinctions refer to the differences in regulations themselves. The substantive distinction this paper focusses on is the non-frustration rule. This regulation features prominently in the United Kingdom and New Zealand frameworks but is largely absent in United States regulation. The non-frustration rule has wide implications for the allocation of decision-making power between shareholders and directors of target companies.

1 Introduction

The non-frustration rule is a form of regulation preventing directors from frustrating a bid to take over the company.[88] The non-frustration rule prohibits directors from engaging in any form of conduct which would lead to the shareholders being unable to value the merits of the takeover offer.[89] The prohibited conduct often comes in the form of "takeover defences" such as poison pills, stock repurchase clauses, golden handshakes or a staggered board re-elections among others.[90] These measures can be broadly classified as "defending" a target company in two ways. Defences such as stock repurchase clauses or poison pills will dramatically devalue a target company, meaning a bidder would extract minimal value from an acquisition. Alternatively, measures such as a golden handshake or staggering the board will mean that even if a bid is successful in acquiring the company the new shareholder will not be able to exercise effective control over the company.

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88 Mathias Habersack "The Non-Frustration Rule and the Mandatory Bid Rule – Cornerstones of European Takeover Law?" (Society and Economy Working Paper, London School of Economics, 2017) at 23.

89 At 6.

90 William Schwert "Takeover Defences" (2013) FIN 423 – Takeover Defences < http://schwert.ssb.rochester.edu/f423/f423def.pdf>.

Replacing the board immediately will either not be possible (through a staggered board) or expensive (with a golden handshake defence). In either instance, these measures are designed to stop an interested party making a plausible takeover bid to shareholders.

Within a non-frustration rule, there are complexities around what will be permitted in the form of defences. The non-frustration rule only applies once a bid has been made to take over a company. Often, there is limited regulation around what directors are able to do in the form of pre-bid defences. In addition to this, directors will still be able to "defend" the company from the bid in the form of their publicised response to shareholders. Directors are able to advise shareholders to reject the bid which may be very influential in the case of hostile takeovers.

In the governance of a company, an agency relationship is created.[91] Directors are elected by the owners or shareholders to govern the business on their behalf. Agency costs arise when directors do not have the same objectives and concerns as the principal.[92] Agency costs can be managed by a number of mechanisms designed to align the directors interests with that of the shareholders. These include performance-based pay, deterrence fines for acting in self-interest or prohibiting certain types of behaviour

The non-frustration rule uses prohibition to address agency costs existing between shareholders and directors. In the event of a hostile takeover, it is likely the directors will be replaced by the acquiring company's appointees. This is because the bidder will view the incumbent directorship as inhibiting the company's value in comparison with what could be achieved under new directors.[93] Even if the takeover offer is one that is objectively favourable to shareholders, the directors will have motivation to sabotage or frustrate the offer to protect their own positions. Therefore, the rule prioritises shareholder interests by compelling directors to abstain from interference in the bidding process.

Critics of this regulatory position have argued that the existing fiduciary duties are adequate to restrain directors from frustrating a takeover bid for personal benefit. In the United Kingdom case of *Hogg v Crampton*, the duties were not seen as being sufficient to ensure directors acted appropriately.[94] Despite the reputational threat and broader duties, there is

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91 Michael C Jensen and William H Meckling 'Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure' (1976) 3 JFE 305 at 308.

92 Dudley Dewhirst and Jia Wang "Board of Directors and Hostile Takeovers" (1992) 4 JMI 269 at 275.

93 Park McGinty "Replacing Hostile Takeovers" (1996) 144 U. Pa. L. Rev. 985 at 988.

94 *Hogg v Cramphorn* [1967] Ch 254.

a further need for mechanisms that address directors acting in their own interest in the instance of hostile takeovers.

The second benefit of the non-frustration rule is that it ensures a competitive market for corporate control.[95] If directors are unable to interfere with the takeover process it allows other companies to make acquisitions that increase value for both themselves and shareholders. The market for corporate control relies on bidding entities being able to take over a company if they believe they can create more value in the acquisition. The rule avoids market inefficiencies due to directors frustrating lucrative bids for personal benefit.

The non-frustration rule has also been subject to criticism which in turn has led to some jurisdictions opting not to introduce it.[96] There are theoretical and practical reasons why the non-frustration rule has been deemed inappropriate. The first of these theoretical reasons is that the directors or management will have greater insight into the company's value than that of the shareholders. There may be long-term plans which are not publicly available but would increase shareholder value. If these are unknown to the shareholders it may lead to them accepting a lower bid. Another reason is that through being able to utilise defensive tactics, target company boards may be able to extract a higher bid from the company looking to acquire.[97] By threatening the use of such tactics it would create an incentive for the acquirer to make a higher offer.[98]

In addition to this, there are concerns that non-frustration rules generate negative externalities for employees.[99] This concern is better known as the team production theory.[100] The theory, when applied to takeover regulation, suggests a director primacy model is more appropriate in encouraging employees to make time and skill investments in the company.[101] If employees feel as though they are vulnerable to changes in shareholder decision-making then they will be less inclined to invest time in specialisation for the benefit of the company. This is contrasted to a managerialist system, where

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95 Julian Franks and Callum Mayer, 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 JFE 163.

96 David Kershaw "The illusion of importance: reconsidering the UK's takeover defence prohibition" (2007) 56 ICLQ 267 at 268.

97 Kershaw, above n 96.

98 Marcel Kahan and Edward B. Rock "How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law" (Faculty Scholarship Paper, University of Pennsylvania Law School, 2002).

99 Habersack, above n 88, at 9.

100 Margaret M. Blair and Lynn A. Stout "A Team Production Theory of Corporate Law" (1999) 85 Va. L. Rev. 248 at 253.

101 At 255.

employees are confident that the longevity of management and directors will mean that they are rewarded through remuneration or promotion structures. Such externalities may generate managerial inefficiencies.

Prioritising shareholder decision-making above all else may have the effect of undermining trust and efficiency in the agency relationship. The non-frustration rule is appropriate in reducing agency costs and maximising short-term shareholder value. However, if the board is required to seek shareholder approval and disclose all information regarding the company's strategy then it may detract from the successful operation of the company itself. This type of disclosure may create inefficiencies through leaking competitive advantages and be impractical in running the organisation.

2 New Zealand and United Kingdom Regulation

New Zealand has incorporated the non-frustration rule in light of these benefits. This has been implemented through director duties, compelling them work in the company's best interests.[102] Rule 38 of the Takeovers Code prohibits defensive action which would result in:

> An offer being frustrated; or the holders of equity securities of the code company being denied an opportunity to decide on the merits of an offer.[103]

The exceptions to this are either where directors have been authorised to do so by shareholders through an ordinary resolution or by encouraging bona fide offers from other potential acquirers.[104] Neither of these exceptions harm shareholder interests as competing offers are likely to increase the value of takeover offers while ordinary resolutions mitigate an agency problem.

In the United Kingdom, rule 21 of the Takeover Code similarly prohibits management from engaging in defensive tactics without the prior authorisation of shareholders.[105] Like New Zealand, the generalised nature of this rule means that the Panel is able to respond flexibly to any measures which target company boards may adopt in order to frustrate a bid.[106] The

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102 Companies Act 1993, s 131.
103 Takeovers Code, r 38.
104 Rule 38.
105 Rule 21.
106 Alexandros Seretakis "Hostile Takeovers and Defensive Mechanisms in the United Kingdom and the United States: a case against the United States Regime" (2013) 8.2 Entrepreneurial Bus. L.J. 245.

same exceptions to the non-frustration rule also apply in the United Kingdom as they do in New Zealand.[107]

3 United States Director Primacy

The United States adopts a different position with the non-frustration rule. There is no legislative law either at state or federal level in the United States which prevents target company directors from deploying defensive tactics to foil a takeover attempt.[108] The courts of Delaware have taken a similar approach in giving directors wide-scope to deploy defensive tactics.[109] The court in *Unitrin* held that provided the defensive measure is not "draconian" it is permissible if a takeover is seen as a threat to the company.

The approach that has been developed is a "director primacy" model of corporate law. In this model directors are given more control over the management of the company and decision-making. The shareholders ability to control the company is limited to reactionary powers, namely the ability to vote in a new board of directors if they disagree with the incumbent board's management.[110] Prima facie, this model appears counterintuitive to the idea that ownership and control ought to accompany one another. Director primacy takes a paternalistic approach to the directors' ability to act in the shareholders best interests. In turn, this forms the basis for allowing defensive tactics as it trusts directors are deploying these tactics with a purpose of maximising shareholder value.

B Self-Regulation

Procedural distinctions are the differences in how regulations are both created and administered. The major procedural distinction between the three jurisdictions is how they are regulated. The mode of regulation has evolved in the United Kingdom since 1968 while New Zealand and the United States have opted to be regulated by statutory bodies and the judiciary respectively.[111] To some degree the original United Kingdom system has been reflected in the quasi-regulation system seen in New Zealand today. In order to understand the distinctions in this regulatory approach is it necessary to analyse the merits of self-regulation in contrast with judicial regulation.

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107 The Panel on Takeovers and Mergers "The Takeover Code" (The Panel on Takeovers and Mergers, 2016).

108 Magnuson, above n 2, at 207.

109 Magnuson, above n 2, at 206.

110 Stephen M. Bainbridge "Director Primacy" (Law and Economics Research Paper Series, UCLA Law School, 2008) at 7.

111 Takeovers Act, s 44Q.

Self-regulation was the original framework established with the Takeover Panel in the United Kingdom. One of the major benefits of this model was that the lack of executive or judicial oversight meant the Panel had significant flexibility.[112] It was able to work cooperatively with the industry to regulate behaviour and could do this in a timely manner without many procedural constraints. Secondly, the Panel stood as the ultimate authority on takeover regulation. Decisions were final and disputes would not be prolonged through judicial appeals.[113] During the introduction of the Takeover Directive one of the major concerns with moving to an externally regulated system, was the use of review as a defensive tactic in itself. Supporters of the existing system were concerned that target company boards would be able to appeal decisions of the Panel with the purpose of delaying the takeover bid and deterring shareholders from potentially accepting the offer.[114]

From a theoretical perspective, having a self-regulatory system addresses information asymmetries between the market participants and the regulator. By utilising the skill set of industry experts, they are in a position where they have the industry knowledge to understand the major issues facing takeover transactions. Judicial regulators may be less privy to all the information required, it increases the likelihood of fault in regulation. Critics would argue that remedying these information asymmetries is only relevant if there is confidence that the market participants will regulate in good faith when they are required to and can manage relevant conflicts of interest. In order for the risk of these abuses to be minimised, two options are available. Firstly, the self-regulatory Panel needs to be cognisant of the threat that they may have their regulatory role removed along with the benefits it carries if there are abuses of power. Secondly, there needs to be some kind of oversight of the self-regulatory body. This can be done by either the judiciary or relevant executive agencies such as the Bank of England or Ministry of Commercial Affairs.

Although the benefits of this model were apparent, the contemporary United Kingdom framework along with the New Zealand and United States models have all moved toward a judicially or externally regulated system. This was in response to concerns about whether bodies that were essentially using executive power should be permitted to do so without giving parties the right to appeal. These calls for appeal were reinforced by the fact that industry participants were also appointed as the regulators themselves, risking the appearance of bias. In addition to this, removing courts ability to regulate decisions made by the Panels, meant there were limited other pathways to appeal arbitrary decisions.

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112 Magnusson, above n 2, at 229.

113 Blanaid Clarke, McCann FitzGerald Chair of Corporate Law "*Datafin* Revisited: Judicial Review During a Takeover Bid" (CELS Lunchtime Seminar, Trinity College Dublin, 4 November 2015).

114 Jonathan Mukwiri "The Myth of Tactical Litigation in UK Takeovers" (2008) 8 JCLS 373 at 375.

1 New Zealand: A Crown Entity

The New Zealand Takeovers Panel is established through statute.[115] Because its powers are derived from the legislature, it forms part of the executive branch of government as an independent crown entity.[116] The Takeovers Act and Code give the Panel significant powers by which to regulate the industry. However, these decisions as part of the executive branch of government are also amendable to judicial review.

The judicial review function has been used several times in relation to determinations made by the Takeovers Panel. In these decisions, the High Court has applied the standard approach that it would when reviewing any decision of an executive agency. This weakens self-regulation as the seriousness at which the High Court will intervene is lower than that of the United Kingdom. However, this increased degree of oversight is arguably validated by the small size of the New Zealand corporate market and consequently the increased risk of conflicts of interests among Panel members. The characteristics of the New Zealand market balanced with the theoretical advantages of self-regulation help explain the regulatory position that currently exists.

2 United Kingdom: Judicial Restraint

The United Kingdom Takeover Panel began as a body which was entirely self-regulating. The Panel gained its authority from corporate consensus where companies who did not comply with the regulator would be "cold-shouldered" from the business community. The speed and flexibility of the Panel has been one of the major benefits stemming from the self-regulatory approach. Similarly to New Zealand, the appointment of industry experts to the Hearings Committee has several benefits.[117] Parties are able to have their claims decided on by individuals who have a high level of insight into the industry. The experts are also able to empathise with the need for expedient resolutions and will act accordingly.

The Panel operates through working cooperatively with code companies rather than legalistically and is able to grant dispensation where it is practical to do so. Further, by working in this manner it allows the Panel to advise parties proactively rather than being compelled to wait until the Code has been breached.

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115 Takeovers Act 1993.

116 Crown Entities Act 2004, sch. 1, pt. 1.

117 The Takeover Panel "Hearings Committee" (2018) The Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/committees/hearings-committee>.

The Panel's authority and the extent to which it was able to be reviewed was an issue addressed in *Datafin*.[118] The Court ruled that exercising what was in effect public power meant that decisions could be judicially reviewed. To limit the problems of encroaching on self-regulation the judge urged future courts to exercise particular restraint in overruling Panel decisions.[119] Because the Panel is afforded both rule-making and application authority, the Court held that intervention should only occur in the event of the rules misleading the public.[120] In the judgment, the Court ruled that any judicial review should be "historic rather than contemporaneous" and that restraint should be exercised in order to preserve the Panel's autonomy.[121] If a judicial review found the Panel had erred in a decision, compensation would be declaratory with the intention of preventing the Panel from making the same mistake.[122]

The Takeover Directive in 2006 created a statutory basis to the Panel's power.[123] The implementation of the directive through the Companies Act 2006 meant that the Panel would be able to impose sanctions to provide legitimacy in its role.[124] Through the Directive, the substantive autonomy of the Takeover Panel was preserved in regulating the industry. The combination of common law alongside statutory regulation has meant that the United Kingdom's regulatory framework is now a quasi-regulated model where authorities outside the Panel will intervene in the most serious of circumstances.

3 United States: Dual Responsibility

The federal system of government in the United States has led to regulation of takeovers falling jointly between federal and state institutions.[125] The SEC and federal regulation regulates the disclosure and procedural requirements of the takeover process. The judiciary, more specifically the Delaware courts, have taken responsibility for deciding what the target board is permitted to do and enforcing misconduct.

The SEC is a statutory body like the New Zealand panel. Its source of power in the form of the Securities Exchange Act 1934 means decisions can be reviewed by a judiciary.[126] The SEC's regulatory role extends to all states and there are several advantages to this.

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118 *Datafin Plc*, above n 64.
119 At 42.
120 At 42.
121 At 45
122 At 45
123 Directive 2004/25 on takeover bids [2004] L142/12; Companies Act 2006 (UK).
124 Companies Act 2006, s 952.
125 Razeen Sappideen "Takeover Bids and Target Shareholder Protection: The Regulatory Framework in the United Kingdom, United States and Australia" (1986) 8 J Comp Bus Cap Mkt L 281 at 286.
126 Securities Exchange Act 1934 (US).

Firstly, by regulating at a national level it allows the federal government to introduce legislation that is important for macroeconomic goals.[127] These goals can include increasing foreign investor confidence, ensuring that there is general economic stability and to encourage retail investors to engage in the market. Secondly, it allows the government to assert some minimum requirements for the process that they believe to be essential regardless of the individual circumstances of the state.

The Delaware judiciary is responsible for the other half of this regulatory partnership. The decisions made in Delaware have influence beyond the state's jurisdiction. While there is variation in takeover regulation between states, the popularity of Delaware as a place to incorporate has meant other courts look to the state's common law for guidance.[128] The disadvantage of having a judicial body as the primary regulator is the way in which law is produced from it. Decisions specific to certain cases may lead to ambiguity over the state of the law which is undesirable in achieving commercial certainty. In addition to this, the judiciary can only perform a reactive role in their regulation of party actions.

From either source of authority, the United States model of takeover regulation is far from self-regulated. Both the SEC's decisions, as part of the Executive, and court rulings lead to a form of judicial-regulation that is dominant in the United States. This may create issues with tactical litigation. Problems arise from tactical litigation when parties use this as a means to increase the expense and lengthen the time required to make a hostile takeover.[129] This can be characterised as a defensive tactic on the part of a target board. However, considering the broad discretion with which the United States allows boards to use such tactics, it may be a more appropriate form of regulation than in New Zealand or the United Kingdom.

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127 U.S. Securities and Exchange Commission "What we do" (10 June 2013) < https://www.sec.gov/Article/whatwedo.html>.

128 JW Eisenhofer MJ Barry *Shareholder Activism Handbook* (2005, Aspen Publishers) at [2.03].

129 Tunde I. Ogowewo "Tactical Litigation in Takeover Contests" (2007) J. Bus. L. 589 at 612.

IV Jurisdictional Reasons for Differences in Regulation

Analysis of the different regulatory frameworks reveal that there are key differences in both the substance and process of takeover regulation between the United Kingdom, the United States and New Zealand. Further, there are reasons with the differences themselves which suggest why countries would choose to adopt different positions.

The paper then turns to country-specific reasons for why differences exist and focuses on three potential reasons. In assessing the reasons in light of suggested law reform two issues ought to be considered. Firstly, how influential have these reasons have been in shaping regulation. Secondly, and if they are influential, do they justify New Zealand continuing its regulatory approach or is change required.

A Federalism

Federalism refers to a the principle of "dividing powers so that the general and regional governments are each, within a sphere, coordinate and independent".[130] While the federal government is often given the ultimate authority to regulate activities, the state regulators are able to elaborate or adapt this federal regulation to accommodate the local jurisdictions preference.[131] In takeover regulation, federalism is characterised by state or regional authorities controlling directors and bidders with different regulations within their jurisdictions. The variation in these standards may lead to states competing amongst one another to induce companies to incorporate with an objective of generating charter revenue.[132] A constant threat of a company choosing to reincorporate in a different state or the opportunity to incentivise more companies to incorporate will lead to regulation adapting over time.[133]

The analysis of federalism as an influence on regulation can be divided into three parts. Firstly, does the influence of federalism favour incumbent directors or shareholders when states compete with one another? Secondly, to what extent is takeover regulation a significant factor for companies in deciding whether to incorporate? Thirdly, how has this appeared in federalist jurisdictions such as the United States and how has globalisation widened the scope of federalism for national jurisdictions such as New Zealand?

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130 K C Wheare *Federal Government* (Greenwood Press, Connecticut, 1946).
131 United States Constitution 1788, art 6.
132 Lucian Arye Bebchuk and Allen Ferrell "Federalism and Corporate Law: The Race to Protect Mangers from Takeovers" (1999) 99 Colum. L. Rev. 1168 at 1171.
133 At 1173.

1 A race to the bottom?

There are two schools of thought that exist in discussing which direction federalist competition can lead regulation in. The "race to the bottom" theory authored by Bill Cary suggests that states will be incentivised to adapt their takeover regulation to favour incumbent directors or managers.[134] By creating rules that allow defensive tactics or restrict bidders ability to takeover a company, it will help secure directors' positions against the threat of replacement. This theory is based on the premise that managers play a large part in the decision-making of where the company will incorporate.[135] Permitting defensive tactics and limiting the market for corporate control means that shareholders may lose value. However, this "race to the bottom" approach will still be acceptable to shareholders if there are more significant factors influencing investment decisions or if information asymmetries exist around takeover law.

The second school of thought is the "race to the top" theory.[136] This theory takes the view that permitting defensive tactics and having regulatory ambiguities has a negative influence on share value. If investors view a state's regulation as being a hindrance to share value then they will instruct directors to reincorporate in a more favourable regulatory environment. In addition to this, the market for corporate control views undervalued companies as the most likely to be taken over. If a state's deficient regulation around the takeover process leads to a lower share price, this will increase the probability of a takeover.

Between these two theories it is important to note that actual situation may be a combination of the two. If a state opts for one extreme in the form of very heavy regulation or no regulation at all, this will deter the directors and shareholders respectively and lead to "compromise" states being favoured as locations to incorporate. Secondly, often shareholder interests will be aligned with that of the directors. Directors and managerial compensation is often tied to the performance of the company.[137] If the company is underperforming as a result of regulation, then incumbent directors will have a personal incentive to reincorporate elsewhere. However, this line of reasoning relies on compensation from company performance surpassing the fixed private benefits that directors receive regardless of performance.

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134 William L. Cary "Federalism and Corporate Law: Reflections upon Delaware" (1974) 83 Yale L.J. 663 at 705.

135 Bebchuk, above n 133, at 1174.

136 Ralph K. Winter "State Law, Shareholder Protection, and the Theory of the Corporation" (1977) 6 J. Legal Stud. 251.

137 Bebchuk, above n 133, at 1175.

2 Limitations of Federalism

The second issue to consider is how influential takeover regulation is when it comes to company decisions to incorporate in a certain jurisdiction. There are theoretical reasons why the influence may not be as strong as academia suggests as well as practical evidence, which will be referred to when analysing the effects in the United States.

When companies are making the decision about whether to incorporate there are a multitude of factors that will be considered. These include, but are not limited to, variables such as the company taxation rates, the availability of financial capital, the quality of infrastructure as well as the quality of the judiciary. While directors certainly may have an interest in being protected in their position, incorporating in a state which fails to benefit the company through any other incentive may prove difficult to justify to shareholders.

However, changing regulation governing takeovers is a variable that will be straight-forward for a state jurisdiction to adjust with minimal negative externalities elsewhere. This can be contrasted with a variable such as taxation rates, where trying to increase such incentives would come as an the expense to the state. Although this may come at the convenience of the state, evidence is conflicted as to the importance of regulatory incentives on incorporation in federalist systems.

3 Federalism in the United States and the United Kingdom

The United States operates in a federal system of government. Different states are able to implement different standards of takeover regulation within federal statutory constraints such as the Williams Act 1968. This contrasts with the United Kingdom's approach where the Takeovers Panel and the legislature regulate all transactions in the national jurisdiction.

Federalism and competition for companies to incorporate has been seen most vividly in the state of Delaware. Despite Delaware's size, and having no extraordinary access to infrastructure or capital, over 60% of Fortune 500 companies have elected to be incorporated in the state.[138] Delaware's corporate law system has drawn acclaim since the l980s and has led to a surge of companies incorporating in its jurisdiction. There is evidence that incorporating in Delaware increases shareholder value rather than diminishing it.[139] At face value this may suggest that a director-primacy model is in the shareholder's financial

138 Delaware Division of Corporations "About the Division of Corporations" Delaware.gov <https://corp.delaware.gov/aboutagency/>.

139 Robert Daines "Does Delaware law improve firm value?" (2001) 62 J. Financial Econ 525.

best interest however this would be to neglect other factors and overstate the differences in regulation between states.

While Delaware courts have given directors a wide scope to deploy defensive tactics and restrict takeovers, the current state of its regulations are not exceptional to other states. This has led critics of the "race to the bottom" theory to suggest federalism does not exert the degree of competitive pressure that has previously been suggested. In addition to this, the state's expedient dispute resolution system is another factor which may attract companies when they are deciding where to incorporate. Based on this analysis, it would appear that such regulation has a minimal effect on influencing share value and the effect of an efficient legal system overcompensates for any detriment.

Prima facie, the position of United Kingdom regulation and the lesser influence of federalism would support the orthodox view of a "race to the bottom". In this jurisdiction, the Takeover Panel and Code are the national regulatory instruments. They are not required to compete with any sub-jurisdictions within the United Kingdom to entice incorporation. Supporters of the theory would cite the lack of managerial influence through federal competition as reflected in the substance of the takeover regulations seen presently. The United Kingdom, as seen in the analysis of the non-frustration rule, operates a system which prioritises shareholder decision-making and restricts director's ability to interfere with a takeover bid.

However, viewing federalism as a dichotomy is an oversimplification of the realities in the European Union. Legislation such as the Cross-Border Mergers Directive 2005 has been passed specifically for the purpose of trying to make cross-state cooperation easier.[140] In terms of federalism, policies designed to make corporate cooperation easier lead to entities such as the European Union having more of a federal presence over member states. This has the potential to create a similar trend of regulatory competition as seen in the United States.

4 Relevance to New Zealand

The New Zealand system of regulation in terms of federalism or nationalism aligns more closely with the United Kingdom. There is a national system of government and a national regulatory body in the form of the Takeover Panel. New Zealand serves as an interesting comparator of how strong the influence of regulatory discretion is in attracting companies

140 Directive 2005/56 on cross-border mergers of limited liability companies [2005] L310/1-9.

to incorporate. It does not have particularly lenient taxation laws or significant access to capital however it has adopted regulation similar to the United Kingdom.

When comparing New Zealand and the influence of federalism on regulatory decision making, this must be analysed through an international lens. While within New Zealand, the panel and any regulatory instruments do not have any sub-jurisdiction to compete with, this analysis does not consider the potential for companies to incorporate in other countries. Companies in New Zealand may already have an incentive to shift their operations off-shore to reap the benefits of working in a bigger economy. This was seen in 2017, with the company Xero choosing to list on the Australian stock exchange rather than the New Zealand equivalent.[141].

Attracting foreign investment and encouraging companies to base operations in New Zealand has been a policy goal for multiple governments in passing takeover regulation. However, the small size of the New Zealand economy suggests it is unlikely major companies would reincorporate in the jurisdiction. The lack of federal pressure on the jurisdiction to adopt director-friendly regulation is helpful for analysing the New Zealand position. While some states may be motivated by incorporation fees rather than economic efficiency, New Zealand has not had the opportunity to compete for such fees. It is arguable that New Zealand's approach to corporate governance creates a system which is more focussed on improving its regulation of takeovers than attracting revenue.

B Institutional Shareholdings

The second factor this paper will consider is the influence of institutional investment and the effect this may have on substantial and procedural takeover regulation. Between the United Kingdom, the United States and New Zealand there have historically been different levels of institutional investment both in quantity and as a proportion of the equity market ownership. In the 1950s, institutional investment accounted for less than 10% of share ownership in the United States but by 2001, institutional investment had surpassed individual ownership.[142] The three jurisdictions now have a comparable level of institutional investment. What is more important though, is an analysis of historic ownership trends to establish causal links between institutional investment at a formative time and regulation that developed.

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141 Brian Gaynor "Xero sends a message to the market" *The New Zealand Herald* (online ed, Auckland, 11 November 2017).

142 Armour and Skeel, above n 61, at 1768.

Institutional shareholdings are ownership stakes in companies held by large financial organisations.[143] These often encompass:

> "pension and superannuation funds, investment companies, banks and charitable foundations. It also includes funds managers who are professionals managing investments on behalf of other institutional investors"[144]

These large financial organisations are often characterised with significant financial expertise alongside owning large proportions of publicly listed and private companies.

There are two theoretical effects institutional investment may have on takeover regulation. Firstly, on an individual company basis, they can hold directors to account due to their expertise and financial influence.[145] The significant capital they control may incentivise companies to incorporate certain rules in their charter preventing directors from acting without shareholder approval for fear of deterring institutional investors. This internal lobbying power is combined with heightened commercial expertise as investment experts are likely to be more aware of the company's performance and exert continuous pressure on the incumbent board. Further, the level of expertise and resourcing available to institutional investors will mean that they may be able to monitor breaches of any fiduciary duties more closely and be more reactionary in removing or disciplining directors in contrast with retail investors.[146]

The second effect institutional investment can have is through lobbying the government to prioritise shareholders in their rule-making capacity.[147] Lobbying may lead to the creation of regulatory bodies where institutional investors are represented or a could instead be influential in a prohibition on directors frustrating takeover bids. Due to their size, institutional investors are able to have a more powerful lobbying influence on the regulator or government than individuals asking for reform. As shareholder interests are more diluted, it reduces their lobbying power both in terms of investment in companies and with the regulator themselves.

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143 Armour and Skeel, above n 61, at 1767.

144 John Farrar, *Corporate Governance – Theories, Principles and Practice* (3 ed, Oxford University Press, Melbourne, 2008) at 362.

145 Armour and Skeel, above n 61, at 1170.

146 David Parthiban and Rahul Kochhar "Barriers to Effective Corporate Governance by Institutional Investors Implications for Theory and Practice" (1996) 14 EMJ 457 at 457.

147 Armour and Skeel, above n 61, at 1771.

1 Delayed institutionalisation in the United States

In the United States, there was initially significant opposition to institutional investment from government regulators.[148] There were concerns around what monopolistic shareholders would do to individual investors. The increase in institutionalised investment was the result of two factors: regulation and consumer demand.[149] In 1974, the federal government passed legislation establishing pension plans which led to major growth in private pension funds.[150] While the effect was not instantaneous, this policy represented a significant move away from earlier concerns centred around the monopolisation of the share market. The pension fund growth allowed retail investors to engage with the stock market in a more accessible manner, namely by investing in funds where their interest would be managed on their behalf.[151] The enormous demand for such services meant that the fees charged by such funds were comparatively low due to economies of scale.

While resistance to institutional investment had eased over time, by this point the director primacy model of regulation had already taken hold in the United States. The absence of institutional investment at the time of regulation being developed, supports the theory of institutional investors playing an important role in protecting shareholder rights.

2 Investor Apathy in the United Kingdom

Contrary to the United States, institutional investment in the United Kingdom appeared at an earlier stage. British funds did not face the initial opposition to growing their presence as was faced by their United States counterparts. Until the late 1970s there were comparatively very high taxation rates with tax credits being afforded to institutional funds.[152] This encouraged retail investors to use these schemes as a result.

Institutional surpassed individual investment by the early 1970s around the time in which the Takeover Panel and Code was being established. The implementation of the non-frustration rule, along with institutional investor representatives making up part of the Takeover Panel membership, suggest lobbying has been successful.[153] At first glance, this would support the theory that the presence of institutional investment leads to a more shareholder-friendly approach to regulation. However, a closer analysis of the behaviour

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148 Armour and Skeel, above n 61, at 1768.
149 Edward B Rock "Institutional Investors in Corporate Governance" (Faculty Scholarship Paper, University of Pennsylvania Law School, 2015) at 5.
150 Employee Retirement Income Security Act 1974 (US).
151 Edward B Rock, above n 149, at 6.
152 Armour and Skeel, above n 61, at 1770.
154 The Takeover Panel "Panel Membership" (22 September 2018) The Takeover Panel <http://www.thetakeoverpanel.org.uk/structure/panel-membership>.

from institutional investors suggests this may be an instance of correlation rather than causation.

In 2010, the Financial Reporting Council introduced the "Stewardship Code" for the purpose of engaging institutional investors more in the corporate governance of companies.[154] The Code placed requirements on these investors including active monitoring of invested companies, guidelines indicating when they as an investor would intervene, and reporting regularly on their "stewardship responsibilities".[155] It had appeared that despite institutional investors acting as an unofficial regulator of directors in theory, this had not come to pass in practice. The late addition of such a Code draws scepticism as to whether institutional investment was indeed as much of a cause in forming takeover regulation as theory would suggest.

3 Institutional Investment in New Zealand

In New Zealand, there has been a comparable growth in institutional investment to that of the United Kingdom or United States. In 1962, major institutional investors controlled approximately 18 percent of the market.[156] This grew to 33 percent in 1974, then to 52 percent in 1981.[157] This significant growth from an early stage is more consistent with institutional growth in the United Kingdom than the United States. This again validates the New Zealand regulatory framework as being more closely aligned to its commonwealth partner.

Out of the three jurisdictions New Zealand has the youngest regulatory framework. The delay in developing a set of rules regarding takeovers meant that by the time the Panel was established in 1993, with the Code yet to come, institutional investment had cemented its place in the New Zealand share market. The consequential shareholder-friendly approach of the regulation is consistent with the institutional investment theory.

Section 126 of the Companies Act 1993 creates a novel development between directors and institutional investors in New Zealand.[158] As per s 126(1)(b)(ii), a director is defined as "a person in accordance with whose directions or instructions the board of the company may be required or is accustomed to act". This suggests that if an institutional investor were

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154 Financial Services and Markets Act 2000 (UK), s 2(4).

155 Ben W. Heineman "A "Stewardship Code" for Institutional Investors" (18 January 2010) Harvard Business Review < https://hbr.org/2010/01/a-stewardship-code-for-institu>.

156 Aik Win Tan and Trish Keeper "Institutional Investors and Corporate Governance: A New Zealand Perspective" (Working Paper, Victoria University of Wellington, 2008) at 6.

157 At 6.

158 Companies Act 1993, s 126.

to obtain sufficient influence over the board then they may be regarded as a director themselves. Section 126 creates a peculiar relationship between parties and may mean that the dichotomy previously suggested between shareholder rights and director primacy is somewhat diminished in New Zealand.

C Political Economies and Ideologies

The final reason analysed in this paper as a potential cause for divergence in takeover regulation are underlying political ideologies which influence regulation. Between the three different countries there are different political leanings and ideologies which have influenced many regulatory efforts. Ideology can be defined as an action-orientated system of beliefs.[159] These beliefs can then be translated into how they solve problems, or more specifically, form policy. Beliefs can vary greatly, extend further than just commercial regulation and are often influenced by what the ideologue perceives as being moral or right. Depending on these ideological factors, a jurisdiction will formulate regulation in a way that is consistent with accepted principles.

In terms of jurisprudence, the idea of allowing an ideology or moral code to shape one's laws is referred to as naturalism.[160] Arguably, the purpose of regulation, and law more broadly, is to prevent such ideologies from influencing decision making. However, an analysis of the economic ideologies that exist in the different jurisdictions suggest that law itself is susceptible to be influenced by these underlying beliefs.

The way in which ideology may inform decision-making is two-fold. Firstly, this can occur formally through pre-existing rules or laws. Courts may find themselves bound by legal precedent such as in Delaware where they were compelled to follow a market-based approach to regulation. This will also apply to instances where federal statutes such as the Williams Act bind states when they seek to introduce anti-takeover legislation due to the supremacy clause.[161]

Secondly and more subtly, ideologies can influence regulation subconsciously during the decision-making process. If regulators are part of a society which holds certain values such as economic liberty with the utmost importance, it is likely this will be reflected in what they are willing to restrict by way of corporate behaviour. Likewise, in a society where it

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159 Christine Sypnowich "Law and Ideology" (22 October 2001) Stanford Encyclopedia of Philosophy <https://plato.stanford.edu/entries/law-ideology/>.

160 Brian Leiter "Naturalism in Legal Philosophy" (15 July 2002) Stanford Encyclopedia of Philosophy <https://plato.stanford.edu/entries/lawphil-naturalism/>.

161 United States Constitution, art 6.

is held the government's role in protecting investors is extensive, then this will have the opposite effect. This system of confirmation-bias will occur where policy-makers are more inclined to accept what they are familiar with and consequently such ideological trends are continued.[162]

1 Free Market Economics in the United States

The United States is well known for its laissez-faire approach to economics and ideology. Laissez-faire economics is the idea that the government's influence and role ought to be limited.[163] This ideology can be traced to the economist Adam Smith who developed the theory in the late 18th century. Smith's work was adopted and reformulated by the Chicago School of Economics which focussed on a promotion of liberalism in the United States.[164] The limited government approach has manifested itself in many aspects of policy and takeover regulation is no exception. The "limited government" approach has been taken to apply primarily to that of the federal government but also to the municipal authorities as well.

Laissez-faire economics and the limited role of government has found significant popularity among politicians and the public in the United States. A lack of trust in the federal government has been dominant since the 1970s.[165] This lack of trust has translated into politicians advocating for a reduced role of government and policies of deregulation.[166]

How has this market-driven approach to regulation and a belief in small government been reflected in regulation? In terms of procedural differences, this can go some way in explaining a greater reliance on the state judiciary to perform a regulatory role. Concerns about the over-reach of the federal government can be addressed by two policy differences. Firstly, the regulatory role of an executive agency such as the SEC, can be shared with the judiciary which is seen as being more detached from the central government. Secondly, the reliance on state courts as opposed to federal courts is consistent with a general aversion to the federal control of economic activity.

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162 James C. Cooper and William E. Kovacic "Behavioural Economics: implications for regulatory behaviour" (2012) 41 J. Regul. Econ. 41 at 48.

163 John F Henry "The Ideology of the Laissez Faire Program" (2008) 42 J. Econ. Issues 209 at 210.

164 RB Emmett *The Elgar Companion to the Chicago School of Economics* (Edward Elgar, Massachusetts, 2010) at 133.

165 "Why America has a trust problem" *The Economist* (online ed, Washington DC, 25 April 2017).

166 Ronald Reagan, President of the United States "Inaugural Address" (Presidential Inauguration, Washington DC, 20 January 1981), "government is not the solution to our problem; government is the problem".

For substantive differences such as the non-frustration rule, regulation is consistent with the free-market ideology. The courts have expressed a reluctance to intervene and restrain incumbent directors from deploying defensive tactics.[167] However an underlying belief that government should not intervene supports the adopted regulatory model.

In contrast to these findings, critics may point to the disclosure requirements which are enforced by the SEC as movement against laissez-faire economics. It is reasonable to assert that adherence to a strictly limited government model has not occurred in the United States. However, when looking at broad regulatory trends, the aversion to federal government influence in contrast with New Zealand or the United Kingdom is clear. The United States' belief in the market is reflected in the minor amount substantive regulation.

2 State Nationalism in the United Kingdom

In contrast to the United States, political ideology in the United Kingdom has broadly been influential on the government in its provision of public services.[168] The two major political parties have both been supportive of the state intervening for collective benefit. This belief is reflected in the more interventionalist regulatory scheme that exists for takeovers. Similarly to New Zealand, the United Kingdom has sought to restrict the rights of incumbent directors for the greater benefit of other stakeholders. Further, the regulatory body has a been given a more extensive role than the SEC. The Takeover Panel is responsible for reviewing individual cases, requiring disclosure as well as reforming regulations. The SEC does not perform the first of these functions which goes some way in explaining the increased role of the state in the United Kingdom.

The second, and more recent, component of the United Kingdom's ideological makeup that has contributed to takeover regulation is nationalism. This nationalism and aversion to being bound by international bodies has surfaced over the past few decades culminating in a decision to leave the European Union.[169] However, prior to this departure, the nationalist attitude was reflected in international takeover regulation. The Takeover Directive which was implemented across the European Union was largely a reflection of the existing regulatory framework that already existed in the United Kingdom.[170] This can be attributed to the fact the regulation used in the United Kingdom had been largely successful up until

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167 *Unocal Corp. v Mesa Petroleum,* above n 84.

168 R Leach *Introduction: Ideology in British Politics* (2nd ed, Palgrave Macmillan, Basingstroke, 2012) at 20.

169 European Union (Notice of Withdrawal) Act 2017 (UK).

170 Hamnered, above n 68, at 1.

this point. But the more ideological cause was that the United Kingdom was largely unprepared to compromise due to nationalist or Eurosceptic reasons.

This paper does not seek to make determinations on whether this nationalist or interventionalist tendencies are desirable for developing regulation. Instead it would assert that the United Kingdom's position may be more simply explained by these ideological traits as opposed to the substantive benefits of shareholder primacy or self-regulation. While these ideological factors may be impossible to quantify, they have undoubtedly been relevant in policy-makers decisions.

3 New Zealand's Position

This paper focuses on two parts to New Zealand's ideological make-up which have influenced takeover regulation. Firstly, New Zealand is similar to the United States and the United Kingdom in the sense that it also operates as a liberal democracy. However, in New Zealand can also be characterised as a social democracy where a heightened role of government is seen as necessary. Secondly, globalism is also a significant ideological influence on New Zealand's regulatory framework.

A social democracy is based on the belief that capitalism is important for the purpose of economic growth however it ought to be regulated by the government to mitigate negative effects capitalism generates.[171] This idea of the government acting as a regulator and provider of certain services inflates the government role envisaged by laissez-faire economists. In New Zealand, the social democratic ideology can be seen to have manifested itself in healthcare, education as well as a universal accidental injury scheme. The premise that the government should have a more enhanced role has also reflected itself in takeover regulation. The establishment of the Takeover Panel as a Crown entity puts the regulatory body directly under the executive's control.[172] This is contrasted with the United States using the judiciary or the United Kingdom previously opting for a self-regulated model.

In addition to this procedural distinction, New Zealand has also opted to regulate director activity more. There are greater restrictions on directors through the prohibition of defensive tactics.[173] The Takeover Code contains additional disclosure requirements such

171 Sheri Berman "Understanding Social Democracy" (Research Paper, Friedrich Ebert Foundation, 2005) at 36.
172 Takeovers Act 1993, s 5(2).
173 Takeovers Code 2001, r 38.

as obtaining an independent advisors report on the proposed takeover.[174] In contrast, these regulations are not present nor required by the SEC in the United States.

The second component of New Zealand's economic ideology which has been influential is globalism. Much of the regulatory reform in the 1990s was prompted either by events in the takeover sphere happening overseas or due to an effort to improve New Zealand's international reputation among investors.[175] New Zealand has paid significant attention to its international reputation due to its reliance on foreign investment. Policy analysts and politicians ensured regulations are established in such a way that is accessible to foreign investors. Geographically, New Zealand is somewhat isolated from major sources of infrastructure and financial capital.[176] This desire attract foreign investment has contributed to New Zealand establishing a regulatory approach that will prioritise the control rights of shareholders. Additionally, shareholders can rely on regulators such as the Takeovers Panel working cooperatively with the industry to protect these rights.

The general themes of globalism and social democracy align with the regulation that governs takeover activity in New Zealand. While these principles are not absolute in their application, they form at least part of the explanation for why regulation has developed reactively to international events and favours state intervention.

174 Takeovers Code 2001, r 18.
175 (24 September 1963) 336 NZPD 2017.
176 Ministry of Business, Innovation & Employment *What we know (and don't know) about economic Growth in New Zealand* (Ministry of Business, Innovation & Employment, Working Paper 16/01, July 2016) at 10.

V Law Reform for New Zealand Regulation

Having analysed differences in takeover regulation between the jurisdictions and evaluated reasons for why these differences have developed, the paper now turns to the future of regulation in New Zealand. Current takeover regulation in New Zealand sufficiently serves the present market requirements. But this sufficiency is in part because the system has not faced the same level of commercial activity as seen in the United Kingdom or United States. By implementing changes the other two jurisdictions have made, New Zealand can proactively reform takeover regulation with an expectation that commercial activity will grow. The analysis of the three systems and reasoning behind regulatory differences helps inform suggestions for reform.

Two suggestions are made in this paper to improve the current New Zealand regulatory framework. Both these suggestions are based on the premise that New Zealand will continue to pursue regulation promoting shareholder primacy as opposed to fundamental reform to the direction of the United States model.

The first of these suggestions is to encourage institutional investors to take a more active role in corporate governance. This would seek to support the Takeover Panel in their oversight of incumbent directors. The second suggested reform is an increased reliance on the Takeover Panel rather than the judiciary as a dispute resolution body. The enforcement function of the Takeover Panel should be supported by the judiciary intervening in only the most serious of cases.

A Utilisation of Institutional Investors

A pervasive problem across the United Kingdom and the United States is the lack of active participation by institutional investors in corporate governance. The presence, or lack of, institutional investment is a reason why regulation exists as it does. However, to make such regulation more effective it ought to be supported by these large investors who have the resources and expertise to monitor incumbent directors. While takeover bids support the market for corporate control, there are less drastic ways to improve company performance outside the threat of a hostile takeover. If institutional shareholders are engaged with directors' actions, it will help hold them to account. A high level of engagement will apply consistent pressure on directors to ensure they perform to a high level. The omnipresent threat of active institutional investors replacing directors if they fail to perform generates many of the same advantages as the market for corporate control itself.

As mentioned, the United Kingdom addressed this shareholder apathy through the Financial Reporting Council introducing the "Stewardship Code" in 2012.[177] The Code required institutional investors to monitor their investee companies and report to the Council on how they were performing this monitoring role.[178] New Zealand has high levels of institutional investment similar to the United Kingdom and the United States. Further, the high level of foreign investment may lend itself to investors being more rationally apathetic due to geographical detachment from the investee companies resulting in increased monitoring costs.

This paper suggests the adoption of a similar form of code with a "comply or explain" level of enforcement. By introducing this type of soft-enforcement it would encourage investors to comply in order to avoid more serious regulatory efforts such as imposing fiduciary duties on majority shareholders.[179] The code ought to be produced and administered by the Financial Markets Authority in New Zealand rather than the Takeover Panel. While it would support the regulatory efforts made by the Panel, monitoring such stewardship requires continuous oversight of the institutional investors' efforts. The Financial Markets Authority would be better resourced to perform this role and already has access to relevant information via its role as regulator of the financial markets.[180]

B Executive or Judicial Regulation

The second reform proposed is a readjustment of the role that courts and the Takeover Panel perform in enforcing the Takeover Code. The courts and the Takeover Panel represent two separate branches of government, namely the judiciary and executive respectively. Currently, the judiciary performs the role of regulating the executive's decisions in the form of judicial reviews lodged by the offeror, the incumbent directors or the target company.[181] This role has been fulfilled several times by the High Court in relation to determinations made by the New Zealand Takeovers Panel.

While the right to justice is an important consideration, this paper would suggest the courts take a reduced role in regulating the regulators of takeover activity. In the United Kingdom, courts will intervene in serious circumstances such as when regulations have been

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177 *The UK Stewardship Code* (Financial Reporting Council, Corporate Governance Code, September 2012)

178 At 5.

189 Zipora Cohen "Fiduciary Duties of Controlling Shareholders: A Comparative View" (1991) 12 U. Pa. J. Int'l Bus. L. 379 at 388.

180 Financial Markets Authority Act 2011, s 9.

181 Takeovers Act 1993, s 51.

misleading.[182] This is done despite the Panel now deriving its authority from statute, much like New Zealand. In New Zealand, the standard for judicial review is lower than the United Kingdom. The standard currently applied is in line with a review of any other executive agency's decision. However, by having a comparatively lower standard than the United Kingdom's approach it can undermine the authority of the Takeover Panel and can prolong such disputes. Allowing parties leave to appeal any decision from the Panel can create commercial uncertainty during the takeover process. Consequently, reform that sought to reduce the role of the judiciary in takeover regulation would make the process more efficient and similar the United Kingdom.

The second benefit of reducing the judiciary's role in regulating takeover activity is it would curb what can be described as "reactive regulation" where clarification of the rules only occurs when parties approach the court with a dispute. Issues with this reactive regulation from judicial regulation in the United States is discussed in part three of this paper. By placing more of an onus on the Takeover Panel to formulate these clarifications, it will make regulations more accessible in the form of public releases rather than judgments as seen in the United States. Further, these clarifications will have the benefit of the Panel formulating them with greater resources and a more thorough understanding of the market.

182 *Datafin Plc*, above n 64, at 45.

VI Conclusion

Takeover regulation is an area of corporate law where despite a set of common objectives, jurisdictions have developed a variety of methods on how to achieve them. The United States, United Kingdom and New Zealand all understand the importance of having a regulatory system that balances a company's right to function effectively alongside a shareholder's right to control the company they own. The balance struck varies between these different jurisdictions and has changed within such jurisdictions over the past 50 years.

This paper suggests the inconsistencies in regulation can be explained not by chance but rather a combination of demographic and ideological factors that underlie each of the different jurisdictions. The influence of federalist competition and institutional factors have meant there have been country-specific reasons for the United States and the United Kingdom diverging as they have done. New Zealand's historical proximity and similarities to the United Kingdom jurisdiction has meant such factors can also be attributed to its own takeover regulation development. The influence of ideology in forming policy and specifically takeover regulation cannot be understated. The set of societal norms and beliefs that each of the three jurisdictions hold has led to a corresponding influence in regulation produced. The ideological approaches are reflected in how much trust the respective governments are willing to place in the industry to be left to market forces.

Based on this analysis, this paper asserts the status quo of New Zealand's takeover regulation is largely appropriate for the market it serves and the ideological beliefs held. The two options for law reform look to make minor adjustments in substantive and procedural elements of regulation. An increased role of institutional investors and limiting judicial intervention would go some way in making the regulatory framework more efficient for all parties involved, particularly as the New Zealand economy and corporate sector expands.

The United States' and United Kingdom's regulatory approach provide valuable points of comparison in identifying what regulation has been successful in their respective jurisdictions. These jurisdictions can be used to pre-empt what challenges may face New Zealand regulation in the future as well as how these might be addressed.

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