New Zealand's mandatory bid provisions: Fit for purpose?

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Abstract

Takeovers aimed at obtaining control of listed companies are subject to regulation across the world. A cornerstone of many takeover regulatory regimes is the mandatory bid rule, which obligates the offeror to extend a takeover offer to all shareholders in the target company once control is obtained. Mandatory bid rules are controversial. Arguments for mandatory bid rules suggest they deter exploitative takeovers and guarantee exit rights for shareholders and so incentivise investment in the first place. Arguments against mandatory bid rules suggest they increase the cost of takeovers, deterring value or efficiency increasing takeovers. Ultimately, the question of whether a mandatory bid rule is beneficial is seen as an empirical one. This paper argues that the empirical question cannot be divorced from the particular characteristics of the capital market in which a mandatory bid rule is imposed. New Zealand's capital markets are small by international standards, are relatively dependent on foreign investment and characterised by concentrated ownership. These characteristics suggest the incidence of takeovers in general may be lower, which in turn suggests that its takeover regime should be wary of increasing the costs of takeovers, notwithstanding the benefits a mandatory bid rule may provide. This paper finds that New Zealand's mandatory bid rules, owing to the allowance of partial bids, largely responds to this concern and appears to be appropriate given the characteristics of New Zealand's capital markets.

Subject and topics

Takeover Act 1993, Takeovers Code 2001, mandatory bid rules.

Word count

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I Introduction

A person seeking control of a listed company or, as is the case in New Zealand, a widely held company may go about acquiring control in a number of ways. A typical way in which control may be acquired is through a merger or consolidation. Mergers and consolidations pool the assets and liabilities of two or more companies into a single company, which is either one of the combining entities, or an entirely new company. A merger usually involves corporate decisions, usually by both shareholders and the board, and often by all companies involved.[1]

Alternatively, control may be acquired where a person seeking control deals directly with a company's shareholders. Such transactions, referred to sometimes as takeovers, are effected by private contract between the person seeking control and the shareholders individually. Takeovers may be structured in a variety of ways: private contracts with a single or a small number of important shareholders; purchasers of shares on the market; or a general offer to all shareholders of the target company. Such offers may be either "friendly" (i.e., supported by the management of the target company) or "hostile" (i.e., made over the heads of target management to the shareholders of the target).[2]

Takeovers are subject to regulations across the world. In New Zealand, the Takeovers Act 1993 ("the Act") and the Takeovers Code 2001 ("the Code") regulate takeovers. A cornerstone of takeover regulations in most jurisdictions is the "mandatory bid rule". The mandatory bid rule requires that an acquirer of shares make a general offer to all other shareholders once they have acquired enough shares to obtain control of the target company. A "strict" mandatory bid rule, as in the United Kingdom, obligates the acquirer provide consideration for all acceptances above a certain level.[3] New Zealand has what can be described as a "weak" mandatory bid rule as it allows partial bids. In particular, while an acquirer must make a general offer to all other shareholders once they have acquired enough shares to obtain control, an acquirer is able to specify the percentage of shares sought.[4] In other words, an acquirer is not obligated to provide consideration for all acceptances.

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1 Reiner Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe and Edward Rock "The Anatomy of Corporate Law: A Comparative and Functional Approach" (3rd Ed, Oxford University Press, Oxford, 2017) [*The Anatomy of Corporate Law*] at 183.

2 Ibid, at 205-206.

3 The City Code on Takeovers and Mergers, r 9(1).

4 Takeovers Code 2001, r 9(1).

Mandatory bid rules are controversial and arguments for and against them draw from the differing motivations behind takeovers. Arguments for mandatory bid rules suggest they reduce the "pressure to tender", deter exploitative takeovers, provide ex-ante protection to minority shareholders and incentivise investment. Arguments against mandatory bid rules, on the other hand, argue that they constitute an artificial interference in the "market for corporate control" and make takeovers more expensive, deterring the efficiency enhancing benefits of such transactions. Ultimately, it has been recognised that the question of whether mandatory bid rules are desirable is an empirical matter.

This paper argues that this empirical question cannot be divorced from the characteristics of the capital market in which a mandatory bid rule is imposed. New Zealand's capital markets are small by international comparisons, are relatively dependent on foreign investment and characterised by concentrated ownership. These characteristics suggest the incidence of takeovers in general may be lower, which in turn suggests that its takeover regime should be wary of increasing the costs of takeovers, notwithstanding the benefits a mandatory bid rule may provide. This paper finds that New Zealand's mandatory bid rules, owing to the allowance of partial bids, largely responds to this concern and appears to be appropriate given the characteristics of New Zealand's capital markets.

The scheme of this paper is as follows. Section II provides the legislative framework governing takeovers with a particular focus on the mandatory bid provisions of the Code as well as further background to the key question posed in this paper. Section III discusses the various reasons motivating takeovers in the first place, which act to provide useful context to arguments for and against mandatory bid rules. Section IV goes on to discuss arguments for and against mandatory bid rules and their applicability to New Zealand, given its allowance for partial bids. Section V sets out the characteristics of New Zealand's listed equity markets. Section VI traverses the more than decade long debate on the adoption of the Code in New Zealand, with a focus on the mandatory bid rule. Section VII pulls the discussion to a close and assesses whether New Zealand's mandatory bid rules are appropriate given the characteristics of its capital markets. Section VIII concludes.

II Background

A Legislative framework

Takeovers in New Zealand are regulated under the Act and the Code, with the latter providing the substantive regulation of takeovers. The objectives when formulating the Code, among other things, included:[5]

- encouraging the efficient allocation of resources;
- encouraging competition for the control of code companies;
- assisting in ensuring that the holders of financial products in a takeover are treated fairly; and
- promoting the international competitiveness of New Zealand's capital markets.

As will become apparent later in this paper, while New Zealand's mandatory bid provisions seek to achieve all four of the above objectives, some necessarily conflict with the other.

The Code only applies to code companies. Code companies are companies registered under the Companies Act 1993 that is either:[6]

- a listed issuer that has a financial products that confer voting rights quoted on a licenced market;
- has been a listed issuer of the above form of financial products within the last 12 months; or
- has 50 or more shareholders and 50 or more share parcels.

The centrepiece of the Code is fundamental rule 6. Any person who holds or controls no voting rights, or less than 20 percent, of the voting rights in a company may not become a holder or more than 20 percent of the voting rights in a code company, either alone or together with associates.[7] In addition, if a person holds more than 20 percent of the voting rights in a code company, that person may not become the holder or controller of an increased percentage of voting rights in that code company.[8]

The Takeover Panel ("the Panel") chose 20 percent as the threshold for the Code's application to be one below the level at which effective control of a company will normally pass. This threshold is in keeping with the objectives of the Code of ensuring that all

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5 Takeovers Act 1993, s 20(1).
6 Takeovers Code 2001, r 3A(1).
7 Takeovers Code 2001, r 6(1)(a).
8 Takeovers Code 2001, r 6(1)(b).

shareholders can participate in the transfer of control, i.e., ensuring that holder of financial products in a takeover are treated fairly.[9]

Rule 7 of the Code provides the content of the exceptions to fundamental Rule 6 of the Code. There are six exceptions in total. Of most relevance to this paper are acquisitions under full[10] or partial offers[11] which comply with the Code. Both these rules can be seen as effective "mandatory bid rules" within the Code.

A full offer must be for all the target company's "equity securities" in each class not already held by the offeror.[12] In contrast, a partial offer may be made for less than all the voting securities in a target company.[13] Such a partial offer must be extended to all holders of voting securities of the target company other than the offer.[14] If there is more than one class of voting securities of the target company, a partial offer must be made for a "specified percentage" of the voting securities of each class not already held or controlled by the offeror, with the "specified percentage" being the same in respect of each class.[15] Whether or not offer is full or partial, the consideration and terms of the offer must be fair and reasonable as between classes.[16]

Importantly, an offer under the code must be on the same terms and provide the same consideration for all securities belonging to the same class of equity securities under offer.[17] As noted above, fairness to all shareholders in a takeover is an objective of the Code. The Panel, in formulating the Code, concluded that "fairness" equates to both an equal opportunity to participate and equal treatment of shareholders in terms of the price and conditions offered to them.[18]

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9 Lindsay Trotman, Mathew Berkhan, Susan Watson, Sue Brown and Tom Barnes *New Zealand Company Law and Practice* (online looseleaf ed, CCH) [*NZ Company law and practice*] at [55-095].

10 Takeovers Code 2001, r 7(a).

11 Takeovers Code 2001, r 7(b).

12 Takeovers Code 2001, r 8(2). "Equity security" in this context includes both ordinary shares and options over ordinary shares – see Takeovers Code, r 3.

13 Takeovers Code 2001, r 9(1).

14 Takeovers Code 2001, r 9(2).

15 Takeovers Code 2001, r 9(4). The "specified percentage" is determined under rule 9(6) of the Code and is the percentage of voting securities sought by the offer over the total number of securities of that class not already held by the offeror or bidder.

16 Takeovers Code 2001, r 8(3), 8(4) and 9(5). The fairness and reasonableness of any code offer, as between different classes of securities, must be supported by a report from an independent advisor approved from an independent adviser approved by the Panel. If such a report is obtained, the offer is deemed to comply with the requirement that the consideration and terms of the offer are fair and reasonable – see *NZ Company Law and practice*, above n 9, at [55-100].

17 Takeovers Code 2001, r 20.

18 *NZ Company Law and practice*, above n 9, at [55-100].

A partial offer may take two forms. The first relates to where the offeror has a pre-existing holding or control of 50 percent or less of the voting rights in the target company. In such a scenario, a partial offer that would grant the offeror more than 50 percent of the voting rights in the target company[19] may be made, conditional on the offeror receiving enough acceptances so as to control more than 50 percent of the voting rights.[20] If the offeror does not receive enough acceptances so as to control more than 50 percent of the voting rights, the offer fails.[21] It should be noted that a full offer is also conditional on the offeror receiving enough acceptances so as to control more than 50 percent of the voting rights.[22]

The second form of a partial offer is where 50 percent or less of the voting rights of the target company is sought.[23] Such an offer requires notice that approval is sought to acquire 50 percent or less of the target company's voting rights and that the offer is conditional on approval being obtained.[24] The offer requires a separate voting document where entitled voters (i.e., those shareholders not the offeror or its associates[25]) first decide whether to allow the takeover offer to proceed or not.[26] In addition to deciding whether or not allow such a partial offer from proceeding, security holders have to decide whether or not to accept the offer or not.[27] The offer fails if approval is not given for the partial offer to go ahead or the offeror does not receive enough acceptances to reach the specified percentage of voting rights sought.[28]

If the partial offer of either form attracts more acceptances than the percentage sought, acceptances will be scaled back proportionally.[29] In particular, an offeror must take up the lesser of either the number of securities that equates to the specified percentage as spelled out in the offer[30] or the number of securities shareholders have accepted into the offer.[31] If the offeror does not receive enough acceptances to reach the percentage specified in their offer according to either of the above formulations, the offeror must take up further securities from shareholders with "excess" acceptances. Shareholders with "excess" acceptances are those

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19 Takeovers Code 2001, r 10(1)(a).
20 Takeovers Code 2001, r 23(1)(a).
21 Takeovers Panel "A Basic Guide for Directors about the Takeovers Code" (February 2014) [*Takeover Panel guide for* Directors] at 9.
22 Takeovers Code 2001, r 23(1)(a).
23 Takeovers Code 2001, r 10(1)(b). As with rule 10(1)(a) of the Code, this rule applies where the offeror has a pre-existing holding or control of 50 percent or less of the voting rights in the target company.
24 Takeovers Code 2001, r 10(1)(b)(i)
25 Takeovers Code 2001, r 10(1A).
26 Takeovers Code 2001, r 10(1)(b)(ii).
27 *Takeover Panel guide for Directors*, above n 21, at 9.
28 Ibid.
29 Takeover Code 2001, r 11, 12 and 13.
30 Takeover Code 2001, r 12(1)(a).
31 Takeover Code 2001, r 12(1)(b).

who have accepted more of their shares into the offer than the specified percentage.[32] The offeror takes up the required number of securities from this "pool" of excess acceptances, proportionately across the excess acceptances in the "pool".[33]

B The effect of allowing partial bids

In short, partial offers under the Code have the effect of reducing the cost of prospective takeovers. A partial offer allows prospective offerors to bid for a percentage less than all the securities in a code company, provided they have complied with the provisions of the Code. For partial offers where the specified percentage sought is more than 50 percent, an offeror is only required to take up acceptances which give it, at least, more than 50 percent of the voting rights or, at most, the specified percentage sought. Where a specified percentage less than 50 percent is sought, the offeror is obliged only to take up acceptances that give it securities up to the percentage sought.

This can be contrasted to the cost of takeovers under "stricter" mandatory bid rules such as the one found in The City Code on Takeovers and Mergers ("the City Code") in the United Kingdom. Under the City Code, rule 9 obliges any person who acquires 30 percent or more of the voting rights of a company, or any person who acquires shares which increase his percentage of the voting rights, to extend a general offer to all other shareholders at a price which is no less than the highest price paid for shares of the same class within the last 12 months.[34] The offer must be in cash or accompanied by a cash alternative.[35] The offer can have no conditions attached, except that it must be conditional on the bidder achieving over 50 percent acceptances.[36] Once unconditional as to acceptances, the offer remains open for an additional 14 days.[37] The City Code thus obliges to an offer to provide consideration for all acceptances 50 percent and over. In addition, and unlike the position in the Code, partial offers under the City Code are restricted and requires consent of the United Kingdom Takeovers Panel.[38] The City Code states that in the case of an offer where the offeror would get more than 30 percent, but less than 100 percent, of the voting rights of a company, such consent will not normally be granted if the offeror, or associated persons, acquired significant shares 12 months preceding the application for consent. Consent will also be normally denied

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32 Takeover Code 2001, r 13(b).
33 *Takeover Panel guide for Directors*, above n 21, at fn 3.
34 The City Code on Takeovers and Mergers, r 9(1) and r 9.5(a).
35 The City Code on Takeovers and Mergers, r 9.5(a).
36 The City Code on Takeovers and Mergers, r 9.3(a).
37 The City Code on Takeovers and Mergers, r 9.5(d).
38 The City Code on Takeovers and Mergers, r 36(1). If approved by the United Kingdom Takeover Panel, the process for a partial offer is similar to the one that is followed in New Zealand – see The City Code on Takeovers and Mergers, r 36.5 and 36.7.

if the offeror acquires an interests in shares at any time after the partial offer was reasonably in contemplation.[39]

While both the full and partial offer provisions under the Code are seen as similar to the regime set out in United Kingdoms' City Code in the sense that both codes impose an effective "mandatory bid" requirement as an exception to the prohibition of changes in control of code companies, the acceptance of the partial bid as means of effecting control shifts, without consent of the New Zealand Takeovers Panel, represents the most noteworthy difference between New Zealand and the United Kingdom.[40] The general allowance of partial bids may also be characterised as a "weak" version of the mandatory bid rule.[41]

C The relevance of partial bids to this paper

The presence of a "weaker" mandatory bid rule in New Zealand, with its allowance of partial bids, is central to the question posed in this paper, the question being whether New Zealand's mandatory bid provisions are "fit for purpose" or appropriate given the characteristics of its capital markets.

As developed in a more fulsome way under Section V, New Zealand has a small listed capital market by international standards[42], is characterised by a dependence on foreign ownership[43] and has concentrated ownership.[44] These characteristics suggest that the incidence of takeovers may be lower in general, meaning New Zealand's takeover laws should be wary of increasing the cost of takeovers. Indeed, various scholars have, on the basis of some, if not all these characteristics, concluded that New Zealand has a relatively inactive market for takeovers.[45]

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39 The City Code on Takeovers and Mergers, r 36(2).

40 Nicholas Jennings "Mandatory Bids Revisited" (2005) 5 Journal of Corporate Law Studies 37 [*Jennings*] at 59.

41 For other instances of "weaker" mandatory bid rules, see *The Anatomy of Corporate Law*, above n 1, at 234-345.

42 Lauren Rosborough, Geordie Reid, and Chris Hunt "A primer on New Zealand's capital markets" (2015) Reserve Bank of New Zealand Bulletin 78(3) at 5.

43 Ibid, at 11.

44 Krishna Reddy, Sazali Abidin and Linjuan You "Does corporate governance matter in determining CEO compensation in the publicly listed companies in New Zealand? An empirical investigation" (2015) MF 301 at 314.

45 See, for example, Krishna Reddy, Sazali Abidin and Linjuan You "Does corporate governance matter in determining CEO compensation in the publicly listed companies in New Zealand? An empirical investigation" (2015) MF 301 at 308.

The allowance of partial bids would seem to address such a concern since, as noted above, it has the effect of lowering the costs of takeovers in comparison to "strict" mandatory bid rules. If the cost of takeovers were the only consideration, one may wonder why it is necessary to have mandatory bid rules at all. As discussed later, mandatory bid rules, and even the partial bid rules present in New Zealand, may act to increase the cost of takeovers.[46] If encouraging takeovers was the only objective of takeover regulations, any form of mandatory bid rule would seem unnecessary.

However, takeovers may be motivated by reasons other than efficiency or value creation. In the face of such takeovers, mandatory bid rules are argued as being an effective way of deterring or preventing such takeovers from taking place. Ultimately, any examination of the appropriateness of a jurisdictions mandatory bid rules must take into account the fact that some takeover may not necessarily be in the interest either target or bidder companies and shareholders.

The following sections of this paper expand on these issues. In particular, reasons behind takeovers are canvassed, which include reasons other than efficiency motivations. This discussion in turn provides context to the next section, which canvasses the debate for and against mandatory bid provisions. As will become evident, whether a mandatory bid provision strikes the balance between encouraging efficiency enhancing or value increasing takeovers and deterring or preventing takeovers that are not motivated by such reasons is an empirical question. As alluded to in the introductory remarks, such an assessment cannot be divorced from the characteristics of the capital market in which such a rule is imposed.

III Reasons behind takeovers

A Efficiency enhancing motivations

There is a voluminous economic literature that explains reasons behind takeovers, with some reasons considered more plausible than others.[47] According to one review, there is a substantial body of research that supports the theory that takeovers are motivated by synergy

[46] For instance, obtaining approval from shareholders for a partial bid below 50 percent may be uncertain. A potential bidder may consequently opt for a specified percentage above 50 percent. Under such a scenario, an offer would likely need to be extended beyond the percentage required for effective control. This likely increases the costs of a takeover in comparison to a scenario where no mandatory provision was in place.

[47] Roberta Romano "A Guide to Takeovers: Theory, Evidence and Regulation" (1992) 9 YJREG 119 [*Romano*] at 120.

gains and agency cost reductions.[48] The following discussion separates out efficiency enhancing motivations of takeovers under these two broad categories.

1 Synergy gains

Perhaps the most straightforward and common reason behind takeovers, and mergers and acquisitions generally, is related to operating synergies. Examples include synergistic gains from economies of scale and scope.[49] Economies of scale relate to the scenario where the average cost per unit of good or service decreases with increases in the number of units produced[50], and is usually due to fixed costs being spread over a larger volume of production as a result of the takeover or acquisition.[51] The empirical evidence on the realisation of efficiencies such as through economies of scale from takeovers or acquisitions is, however, somewhat mixed.[52]

Economies of scope can simply be described as the situation where it is cheaper to produce two products together than to produce them separately.[53] More generally, acquisitions may facilitate redeployment of assets and competency to generate efficiencies.[54] A sizeable body of research appears to support that acquisitions may be motivated by economies of scope.[55]

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48 Ibid, at 152.

49 Ibid, at 126.

50 Massimo Motta *Competition Policy: Theory and Practice* (1st ed, Cambridge University Press, New York, 2004) [*Motta*] at 2.

51 *Romano*, above n 47, at 126.

52 For example, some research indicates long-term improvements in plant productivity and public account service delivery as a result of acquisitions – see Robert H McGuckin and Sang V Nguyen "On productivity and plant ownership change: New evidence from the longitudinal research database" (1995) 26 RAND J Econ 257 at 259 and Rajiv D Banker, Hsihui Chang and Reba Cunningham "The public accounting industry production function" (2003) 35 J Account Econ 255 at 274 and 279 respectively. On the other hand, other commentators have argued that post-acquisition performance is not noticeably better than before the transaction and that efficiency gains may differ on a case-by-case basis – see Lars-Hendrik Röller, Johan Stennek and Frank Verboven "Efficiency Gains from Mergers" (2000) The Research Institute of Industrial Economics, Working Paper 543 at 53.

53 See, for example, *Motta*, above n 50, at 2.

54 Jerayr Haleblian, Cynthia E Devers, Gerry McNamara, Masson A Carpenter and Robert B Davidson "Taking Stock of What We Know About Mergers and Acquisitions: A Review and Research Agenda" (2009) 35 J Manag 469 [*Haleblian et al*] at 474.

55 For instance, significant resource alignment has been found between acquirers and targets in horizontal acquisitions – see Lawrence Capron, Will Mitchell and Anand Swaminathan "Asset divestiture following horizontal acquisitions: A dynamic view" (2001) 22 SMJ 817 at 818. Research also indicates that acquiring firms tend exhibit greater change in their resource sets than non-acquiring firms. In particular, acquirers deepened resource sets by adding to existing areas of strength and extending resources into new areas, suggesting managers may use acquisitions as a means of innovation – see Samina Karim and Will Mitchell "Path-dependent and path-breaking change: reconfiguring business resources following acquisitions in the US medical sector, 1978-1995" (2000) 21 SMJ 1061 at 1078-1079. More recently, research has indicated that firms leveraged the innovation-orientated resources of target firms either by integrating those

Another potential operating synergy involves differential managerial ability. The acquiring firm's managers may be good at managing but have excess capacity (i.e., they can efficiently manage more than the assets of their firm). The firm can use these excess managerial resources, and the combination will lead to efficiency gains. This theory assumes that managerial skills are indivisible and are a product of a team.[56]

Synergies may not necessarily be confined to efficiencies and may be financial in nature. Indeed, a popular explanation of merger activity relates to financial synergies.[57] Of the various explanations of financial synergies motivating takeovers or acquisitions, one of the more plausible explanations is that it reduces the cost of capital.[58] Capital costs are higher when funds are raised externally. In contrast, flotation and transaction costs may be reduced if spread over a larger combined entity. The need to raise funds externally or through issuance of securities may be eliminated if the merged entity's cash flow is sufficient to produce all necessary cash internally.[59]

Another financial motivation behind takeovers or acquisitions, particularly conglomerate mergers, is diversification and the reduction of risk. The merging of two income streams may reduce the risk associated with insolvency. This occurs where the merging firms' cash flows are not perfectly correlated. Where this is the case, the debt capacity of the combined firm is increased, reducing the risk of insolvency. This benefit of the reduction in cash flow variability cannot be obtained by either firm separately, and so is considered a financial synergy possible from takeovers or acquisitions. Additional benefits from a reduction in the risk of insolvency include the fact that intangible capital or goodwill that a firm is built up is lost upon bankruptcy. By lowering the risk of bankruptcy, the value of reputational capital (i.e., goodwill) is preserved.[60]

2 Agency cost reductions

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resources into the acquiring firm or by leveraging the innovative capabilities of the firm as an independent unit – see Phanish Puranam and Kannan Srikanth "What they know vs. what they do: How acquirers leverage technology acquisitions" (2007) 28 SMJ 805 at 819.

56 *Romano*, above n 47, at 126.

57 Ibid, at 127.

58 Ibid, at 128.

59 Ibid, at 128.

60 Ibid, at 146.

One of the central insights into reasons behind takeovers is that takeovers can reduce agency costs and lead to more efficient management. Agency costs or problems, in the most general sense, arise whenever one party, termed the “principle”, relies upon the action taken by another party, termed the “agent”, which will affect the principal’s welfare.[61] The problem lies in motivating the agent to act in the principal’s interest rather than simply in the agent’s own interest. The core of the difficulty is that, because the agent commonly has better information than the principal about the relevant facts, the principal cannot easily assure himself that the agent’s performance is precisely what was promised. As a consequence, the agent has an incentive to act opportunistically, skimping on the quality of his performance, or even diverting himself to some of what was promised to the principal. This may mean, in turn, that the value of the agent’s performance to the principal will be reduced, either directly or because, to assure the quality of the agent’s performance, the principal must engage in costly monitoring of the agent. The greater the complexity of the tasks undertaken by the agent, and the greater the discretion the agent must be given, the larger the agency costs are likely to be.[62]

It should be noted that the agency cost or problem described above is an economic concept and distinct to the law of agency. Under the law of agency, agency names a legal relationship between one person, the agent, and another, the principal. Under the law of agency, an agent is engaged for the purpose of engaging a third party or persons in contractual relations with the principal. The existence, nature, and extent of the agency relationship are determined as a matter of law.[63]

Within code companies, the economic agency cost or problem can arise between firms’ owners (i.e., its shareholders) and its appointed managers. Here the owners are the principals and the managers are the agents. The agency problem in this case lies in assuring that managers are responsive to the owners’ interest rather than pursuing their own personal interests.[64] In this context, a takeover is a backstop remedy when other corporate governance devices that monitor performance, such as the board of directors, fail at effective alignment of interests between shareholders and managers.[65]

The notion that takeovers can reduce agency costs and align interest between shareholders and managers within target companies, and in particular, ensure that management is efficient, was first put forward by Manne.[66] Manne put forward the idea that a share price of a listed

61 *The Anatomy of Corporate Law*, above n 1, at 29.
62 Ibid.
63 Thomas Gault (ed) *Gault on Commercial Law* (online looseleaf ed, Brookers) at [AB1.01].
64 *The Anatomy of Corporate Law*, above n 1, at 29.
65 *Romano*, above n 47, at 128.
66 Ibid.

company reflects not only the price at which shares could be sold, but also what it could be with more efficient management. The lower the share price, relative to what it could be worth with more efficient management, the more attractive the takeover becomes to those that believe they can manage the company more efficiently.[67] Takeovers are key mechanism for disciplining managers because, unlike mergers, takeovers largely bypass target management and go directly to target shareholders for approval. The potential of job or reputational losses from takeovers therefore constrain managers to act in the interest of shareholders and keeps capital markets competitive.[68] Hostile takeover activity can therefore be seen as a "market for corporate control" where management teams compete with one another for the right to manage assets owned by shareholders. The team that offers the highest value to the shareholders takes over the right to manage the assets until it is replaced by another management team that discovers a higher value of the assets.[69] The "market of corporate control" and is seen as a crucial element in the promotion of economic efficiency.[70]

There is a range of empirical work which tends to support the notion of a "market for corporate control". Broadly, studies focussing on rates of return find that takeovers are focussed on poorer performing firms and tend to create value for both the target and acquiring firm when considered together, which is broadly supportive of the notion that takeovers act to discipline ineffective management.[71] Other evidence includes evidence of higher turnover of management after takeovers in comparison to friendly takeovers[72], CEO dismissals after takeovers[73][74] and studies finding that target managers are relatively

67 Henry G Manne "Mergers and the Market for Corporate Control" (1965) 73 J POL Econ 110 at 113.

68 *Romano*, above n 47, at 128.

69 Michel C Jensen "Takeovers: Their Causes and consequences" (1988) 2 JEP 21 at 23.

70 Richard Wish and David Bailey *Competition Law* (8th Ed, Oxford University Press, Oxford, 2015) at 858.

71 For instance, some studies find that firms earn low rates of return prior to mergers and acquiring companies are above average profitability – see Paul Asquith "Merger Bids, Uncertainty and Shareholder Returns" (1983) 11 J Fin Econ 51 at 80-82. Other studies, focusing on Tobin's q ratios (this is the ratio of a firm's market value to the replacement cost of its physical assets and therefore measures the firm's intangible assets – goodwill, future growth opportunities and quality of management) find target companies of hostile takeovers are poor performers compared to targets in friendly acquisitions, while others find that target firms have on average lower Tobin q ratios – see Larry H P Lang, Rene Stulz and Ralph A Walking "Managerial Performance, Tobin's q, and the Gains from Successful Tender Offers" (1989) 24 J Fin Econ 137 at 138-139 and Henri Servais "Tobin's q and Gains from Takeovers" (1991) 46 J Fin 409 at 418. Such findings are seen as corroborative of the notion that takeovers discipline management as they indicate that takeovers are focussed on takeovers of poorer performing firms – see *Romano*, above n 47, at 130. Other empirical work notes that takeovers create value for the target (see, for example, Marina Martynova and Luc Renneboog "A Century of Corporate Takeovers: What Have We Learned and Where Do We Stand?" (2008) 32 J Bank Finance 2148 [*Martynova*] at 2153 and Klaus J Hopt "Takeover Defences in Europe: A Comparative, Theoretical and Policy Analysis" (2014) 20 Columbia J Eur Law 249 at 252) may leave the bidder's share value unaffected or it may even cause it to suffer (*Martynova*, at 2159) but increase value for both groups when taken together (*Martynova*, at 2164.)

72 See, for example, Eugene P H Furtado and Vijay Karan "Causes, Consequences, and the Shareholder Wealth Effects of Management Turnover: A Review of the Empirical Evidence" (1990) 19 Fin Mgmt 60 at 63-65.

73 Anup Agrawal and Ralph A Walkling "Executive careers and compensation surrounding takeover bids" (1994) 49 The Journal of Finance 985 [*Agrawal*] at 986 and Kenneth J Martin and John J McConnell "Corporate performance, corporate takeovers and management turnover" (1991) 46 J Finance 671 at 672.

overcompensated prior to takeovers relative to other managers and receive reduced compensation after a takeover, which is argued as reflecting the full playing out of the "market for corporate control".[75]

In addition to the evidence discussed above, and of no less significance, is the fact that the Act made explicit that objectives of the Code were to encourage the efficient allocation of resources and encouraging competition for the control of code companies.[76] The Act and the Code therefore explicitly recognise the potential for synergy gains and more efficient management from takeovers and seek to encourage such activity. Indeed, this can be seen as the motivation behind rule 38 of the Code. Rule 38 of the Code restricts directors of a company from taking action that could effectively result in an offer being frustrated or denying holders of shares in the company from deciding the offer on its merits when they have received a takeover notice or have reason to believe an offer is imminent.[77]

B Non-efficiency enhancing motivations

While there are laudable potential reasons behind takeovers, there is also a voluminous literature that recognises that not all takeovers are undertaken for efficiency maximising reasons, and in particular, are driven by managers attempting to maximise their own self-interest.[78] As will become evident, managers attempting takeovers for their own self-interests can also be characterised as an economic agency cost or problem, but this time, within bidder companies. This section discusses some motivations behind takeovers that may not necessarily be efficiency enhancing.[79]

1 "Empire building"

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74 As noted by Romano, turnover in of itself does not indicate that departing managers are poorer than their replacement. However, Romano notes that if we did not observe turnover of management after takeovers, and if such turnover was unrelated to the targets' performance, than the inefficient management explanation would be in serious jeopardy – see *Romano*, above n 47, at 130.

75 *Agrawal*, above n 73, at 986-987.

76 Takeovers Act 1993, s 20(1).

77 Takeovers Code 2001, r 38.

78 *Haleblian et al*, above n 54, at 475.

79 Given the breadth of potential non-efficiency reasons behind takeovers, the following discussion is necessarily circumscribed. Obvious omissions include takeovers motivated by the potential to gain market power. Such takeovers would necessarily be considered under s 47 of the Commerce Act 1986, which prohibits acquisition of assets of a business or shares that would have, or would be likely to have, the effect of substantially lessening competition in a market.

Rather than undertaking takeovers aimed at maximising shareholders wealth, the motivation for a takeover may be around "self-aggrandizement" or "empire building". As Romano notes, this is the more traditional managerial explanation of takeovers.[80]A number of finance and management scholars have demonstrated important links between upper echelon compensation and ownership and acquisitive behaviour.[81] For instance, industries with higher CEO compensation have been found to generally exhibit greater acquisition activity.[82] In addition, acquiring CEO[83] and director[84] stock option grants are positively associated with such activity.

To reduce agency costs between shareholders and management within bidding companies, contracts should be designed to reduce managerial opportunism and align managers' and shareholders' interest. However a growing body of recent evidence suggests that managers' desire for increased compensation elicits strong, self-interested motivations to acquire. [85] Indeed, this is consistent with evidence demonstrating that acquiring CEO's post-acquisition compensation generally increases, irrespective of acquisition performance, through liberal post-acquisition equity-based pay grants[86], bonuses[87] and other compensation.[88] Additionally, managing larger firms generally also increase CEO discretion and power, which can further entrench managers and reduce their employment risk.[89] This research suggests that acquisitions are generally attractive for CEOs.[90]

2 *Free cash flow for the acquirer*

"Self-aggrandizement" or "empire building" may be a more specific case of the general case where the acquirer is simply making use of excess cash flow.[91] As noted by Romano, several studies provide evidence consistent with this explanation. In particular, these studies show

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80 *Romano*, above n 47, at 130.
81 *Haleblian et al*, above n 54, at 475.
82 *Agrawal*, above n 73, at 986-987
83 Wm Gerrard Sanders "Behavioural responses of CEOs to stock ownership and stock option to pay" (2001) 44 Acad Manage J 477 at 488-489.
84 Yuval Deutsch, Thomas Keil and Tomi Laamanen "Decision making in acquisitions: The effect of outside directors' compensation on acquisition patterns" (2007) 33 J Manag 30 at 32.
85 *Haleblian et al*, above n 54, at 475.
86 Jarrad Harford and Kai Li "Decoupling CEO wealth and firm performance: The case of acquiring CEOs" (2007) 62 J Finance 917 at 918-919.
87 Yaniv Grinstein and Paul Hribar "CEO compensation and incentives: Evidence from M&A bonuses" (2004) 73 J Fin Econ 119 at 120-121.
88 Richard T Bliss and Richard J Rosen "CEO compensation and bank mergers" (2001) 61 J Financial Econ 107 at 135.
89 See, for example, Louis Gomez-Mejia and Robert M Wiseman "Reframing executive compensation: An assessment and outlook" (1997) 23 J Manag 291 at 314-315.
90 *Haleblian et al*, above n 54, at 475.
91 *Romano*, above n 47, at 149. Romano notes that an acquisition making use of excess cash flows may, however, be less wasteful than alternative expenditures the mangers would undertake in its absence.

that bidders experience abnormal positive returns before an acquisition, but they also have low Tobin's q ratios, suggesting that bidders have ample free cash.[92] Other studies provide more direct evidence of acquisitions being motivated by excess cash flows finding that managers who are subsequently disciplined by a takeover are those who initially engaged in negative net present value acquisitions, that is, those who wasted free cash flow.[93]

3 Managerial "hubris"

Another non-efficiency motivation behind takeovers is the "hubris", or exaggerated self-confidence, hypothesis. Under this theory, managers seek to make value-maximising acquisitions, but they make mistakes and overvalue targets (or their ability to turn target firms around). When the bidder's stock price falls upon the announcement of a bid, the managers do not heed this warning of their impending mistake. Rather, they are infected with pride and persist in believing that their valuation is correct and the market is wrong. Their "hubris" prevents them from admitting their mistake and calling off the deal, and they end up paying too much for the target firm.[94]

Recent empirical management research supports the "hubris" hypothesis. Studying a sample 106 large acquisitions in the United States between 1989 and 1992, Hayward and Hambrick study the role of a CEO's hubris in the large size of the premium paid for acquisitions. Hayward and Hambrick find that four indicators of CEO hubris are highly associated with the size of premiums paid. These four indicators were the bidding firm's recent performance, recent media praise for the CEO, a measure of the self-importance (his or her relative compensation in comparison to other employees in the bidding firm) and a composite factor of the three variables. Hayward and Hambrick also find that the greater the CEO hubris and acquisition premiums, the greater the shareholder losses.[95]

A more recent article also provides support for the "hubris" hypothesis. Malmendier and Tate use a sample of 394 large U.S. forms from 1980 to 1994. Using two proxies of

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92 Ibid.

93 Ibid.

94 This theory was first put forward by Richard Roll "The Hubris Hypothesis of Corporate Takeovers" (1986) 50 J Bus 197. As noted by Romano, the "hubris" thesis is related to the winner's curse phenomenon in sealed-bid auctions. When the value to the bidders of the auction item is uncertain, the person who overestimated the value the most will be the winner. In other words, a positive evaluation error produces a winning bid, but a negative error does not. The winning bidder pays too much and winning is bad news (i.e., a "curse") because it signifies that all other bidders' estimates were lower. Put another way, the winner had the higher positive evaluation error – see *Romano*, above n 47, at 150-151.

95 Mather L A Hayward and Donald C Hambrick "Explaining the premium paid for large acquisitions: Evidence of CEO hubris" (1997) 1 ASQ 103 at 103.

overconfidence (a CEO's personal over-investment in their company and their press portrayal), Malmendier and Tate find that the odds of making an acquisition are 65 percent higher if the CEO classified as overconfident. In addition, this effect is larger if the merger is diversifying and does not require external financing. In addition, the authors find that the market reaction at a merger announcement is significantly more negative than for non-confident CEOs.[96]

IV Mandatory bid rules: Arguments for and against

As the preceding discussion demonstrates, there are potentially many reasons underlying takeovers, with some reasons being more positive than others. It also serves to emphasise that encouraging takeovers, in the absence of any other considerations, is unlikely to be a sound approach for takeover regulation. As noted previously, the discussion of the various motives behind takeovers is not without relevance, as they provide added context and detail to argument for and against mandatory bid rules. This section also provides commentary on the applicability of general arguments for and against mandatory bid rules to New Zealand, given its allowance for partial offers.

A Arguments for mandatory bid rules

1 Reducing the "pressure to tender"

The mandatory has been justified on the basis that it reduces the pressure to tender. In the absence of a strict mandatory bid means, a bidder is not obligated to submit an equal offer to all shareholders in a target company. The absence of a bid on equal price for all shares may in fact put pressure on shareholders to accept the offer, for fear that any later offer will be at a lower level or not materialise at all.[97] This may especially be the case where bidders can make two-tier bids (the first bid at a higher price than the second).This "pressure to tender" may also be particularly acute for shareholders who are not controlling or block shareholders in the sense that they feel coerced into accepting a takeover bid on an individual basis notwithstanding the fact that it may be in the best interests of all shareholders to turn down the offer.[98]

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[96] Ulrike Malmendier and Geoffrey Tate "Who makes acquisitions? CEO overconfidence and the market reaction" (2008) 89 J Fin Econ 20 at 20.

[97] *The Anatomy of Corporate Law*, above n 1, at 227.

[98] Klaus Hopt "European takeover reform of 2012/2013 – time to re-examine the mandatory bid" (2014) 15(2) EBOR 143 [*Hopt*] at 152.

Where an offer is value decreasing or its motive is just unclear, such as where "empire building" or managerial "hubris" are at play, the mandatory bid rule removes pressure to tender and thus addresses the coordination problem where by an acquirer may seek to induce dispersed shareholders to accept an offer that is less than optimal.[99] If an offer is value increasing, such as those motivated by synergy gains or agency cost reductions, it can be argued that providing the non-accepting shareholders with an exit right is not necessary. However, it may be difficult for a rule-maker to identify ex-ante which category the offer falls into, so that the choice is between applying or not applying the mandatory bid rule across the board.[100]

It should be noted that partial offers, such as the ones allowed under rule 10 of the Code, are also known to increase the pressure to tender.[101] However, as discussed above, rules 12 and 13 of the Code act to scale back proportionally excess acceptances for a partial offer. Rules 12 and 13 should therefore act to mitigate the pressure to tender to some degree. Specifically, it ensures that acceptances will be scaled back proportionally[102], or if they are excess acceptance, that these will be scaled back on a pro-rata basis.[103] This may alleviate, to an extent, the pressure to accept an offer for fear that a later offer is less than optimal as it prevents acquisition from only selected persons.[104] Where a specified percentage less than 50% of shares is sought, shareholders other than the offeror also vote on whether to let the takeover proceed.

Shareholders are therefore allowed to express their views independently on the merits of the takeover in isolation, which may allow for an undistorted choice. As Bebchuk notes, a target's shareholders may well tender their shares to a bidder even if they view the offered price as lower than the value of the target were it to remain independent. A shareholder might tender their shares for fear that if they do not, the bidder might still gain control, leaving them with low-value minority shares.[105] This "distorted" choice means a target may be acquired even if it is not value-maximising for the transaction to go ahead.[106] Bebchuck proposes that to solve this problem of distorted choice, shareholders should be able to express their views concerning the bid's success in isolation to their desire to receive a pro-rata share of the

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99 *The Anatomy of Corporate Law*, above n 1, at 227-228.
100 Ibid.
101 *Hopt*, above n 98, at 152.
102 See Takeover Code, r 12(1)(b).
103 See Takeover Code, r 13(b).
104 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 Market L 281 at 298.
105 Lucian A Bebchuk "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" (1985) 98 Harv L Rev 1693 at 1696.
106 Ibid.

acquisition price in the event of a takeover[107], although he considers that such a process should be implemented for bids for all shares, and not just partial bids.[108]

2 *Equality and the right to share control premiums?*

A common justification for the mandatory bid rule is that it allows for equal treatment of all shareholders in a target company.[109] In particular, a justification for the mandatory bid rule is that all shareholders in a company in which a shift in control takes place should share in any control premium that is paid.[110] The reasoning for such treatment is said to tie in with an American legal doctrine that held that the right to decide how a company's resources are utilised is an asset that belong to the company, and thus to all its shareholders in proportion to their holdings. Anyone who obtains control of a company by acquiring less than all of its shares and pays for that control by buying the shares at a premium should therefore be forced to make a corresponding offer to the holders of the remaining shares.[111]

This theory was first put forward by Berle and, as noted by Farrar, while there is some US court precedent supporting this theory, it has not prevailed.[112] Indeed, the equality and the right to share control premiums as a basis for the mandatory bid rule has received stringent criticism by other scholars. Enriques considers that this rational is far from convincing. He notes that fairness arguments are hard to dismiss and in the absence of any more specific articulation of why it should be fair to ensure that minority shareholders are treated like majority ones when control is transferred, one can only counter that "fairness is an empty concept into which agencies, courts and lawyers pour a miscellany of unexamined and inconsistent premise".[113] Other authors consider that minority shareholders may benefit from synergies associated with private benefits of control, which may be the monitoring role controlling shareholders undertake over management. As a consequence, there is no

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107 Ibid, at 1748.

108 Ibid, at 1797. In particular, he notes the United Kingdom's City Code partial offer approval process, which requires approval from shareholders not associated with bidder to vote on whether or not to allow such a bid, does not address the problem of distorted choice in bids for all shares.

109 Luca Enriques "The Mandatory Bid Rule in the Takeover Directive: Harmonisation without Foundation" (2004) 4 ECFR 440 [*Enriques*] at 452.

110 Rolf Skog "Does Sweden Need a Mandatory Bid Rule? A Critical Analysis" (1997) 2 SUERF Studies [*Skog*] at 19.

111 Ibid, at 19-20.

112 John Farrar "Company Takeovers – a Critical Examination of the Securities Commission Report" (1989) 13 NZLUR 312 [*Farrar*] at 314.

113 *Enriques*, above n 109, at 452-453.

inequality when a controlling shareholder receives a price premium for such a role.[114] Rather, the mandatory bid rule may provide a windfall for minority shareholders.[115]

Perhaps a more convincing rational for equal treatment and the right to share control premiums underlying the mandatory bid rule is that it deters exploitative takeovers. While an offer may be value-increasing for the target company's shareholders as a whole, the non-controlling shareholders may not obtain in the future their share of the value because of the extraction of private benefits of control by the acquirer. Private benefits of control range from the "psychic" value some shareholders attribute to being in control, the use of company mainly to pay for perquisites to less than fair transfers of certain assets or products from the company to controlling shareholders.[116] Permitting takeovers where only a portion of shares need to be acquired for control may encourage takeovers aimed at extracting the private benefits of control.[117] On this view, mandatory bid rules act as a pre-emptive strike against such exploitative takeovers as the right to exit at a premium ensures that there will be no minority for the new controller to exploit.[118]

However, this explanation is not without issue, at least for New Zealand. On the rationale that mandatory bid rules are designed to deter takeovers where the bidder is seeking to extract private benefits of control, the mandatory bid rule should be accompanied by a prohibition on partial general offers, even where, through a pro rata acceptance rule, all target shareholders are treated equally. In addition, were this the rationale for the mandatory bid rule, one would expect to find a rule requiring comparable offers to be made for all classes of equity shares in the target, whether those classes carry voting rights or not.[119] As discussed previously, New Zealand does allow partial takeover bids. The rationale that mandatory bids are aimed at deterring takeovers where the bidder is seeking to extract private benefits of control may therefore not be as applicable to New Zealand.

3 Ex-ante protection and spurring investment

Another common justification, not founded under principles of either company law or security law, is that it provides shareholders an opportunity to sell their interests in the event

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114 Mathias Habersack "Non-frustration Rule and Mandatory Bid Rule – Cornerstones of European Takeover Law? (2018) 15 ECFR 1 [*Habersack*] at 30.

115 Ibid, at 28.

116 See, for example, Alexander Dyck and Luigi Zingales "Private Benefits of Control: An International Comparison" (2004) 59 J Finance 537 at 540.

117 *The Anatomy of Corporate Law*, above n 1, at 228.

118 Ibid, at 234.

119 Ibid, at 228.

of a change in control of a company.[120] The mandatory bid rule therefore operates to protect, ex-ante, shareholders from the risk that the controlling shareholder may exert their influence in a manner that is detrimental to remaining minority shareholders.[121] This justification appears to be related to the justifications discussed above. Takeovers may be motivated for reasons other than those related to synergies and agency cost reduction such as by notions of "empire building", managerial "hubris, or simply by an aim to extract the private benefits of control. A mandatory bid not only reduces the pressure to tender in such takeovers, but also provides an opportunity for exit should a shareholder wish to do so.

Of course, a change in control does not prevent unhappy shareholders from selling their shares on the market. However, such an option may be second best. If a significant number of shareholders sought to sell their shares at the same time, market price for such shares is likely to fall. There may also be a lack of prospective purchasers for the very reason shareholders are seeking to sell.[122]

As noted by Kraakman et al, it can be argued that there is a vital difference between purchasing control from a controlling shareholder and acquiring it from the market in a widely held company. In the former case, the minority shareholders are no worse after the control shift than they were previously.[123] However, such a view ignores the risk which the control shift generates for the minority. The acquirer, even if it does not intend to loot the company, may embark upon a different and less successful strategy, maybe less respectful of the minority's interest and rights or may simply use the acquired control to implement a group strategy at the expense of the new group member company and its minority shareholders.[124]

The ex-ante protection rationale for the mandatory bid rule has received criticism on the grounds that it is based on the unfounded assumption that a change in control is typically detriment to the company's other shareholders. In any event, it may be illogical to require the controlling shareholder to extend a mandatory bid until it has been proven that harm has actually occurred.[125] Other authors argue that ex-ante protection is not justified given the deterring effect mandatory bid rules have on value-increasing takeovers, and the follow on effects this may have.[126] Others argue that ex-post protection can be provided for in by other

[120] *Skog*, above n 110, at 19.
[121] *Habersack*, above n 114, at 29
[122] *Skog*, above n 110, at 19.
[123] Ibid.
[124] *The Anatomy of Corporate Law*, above n 1, at 233.
[125] *Skog*, above n 110, at 19.
[126] See, for example, *Enriques*, above n 109, at 448-449. I discuss the deterring effect mandatory bids may have on value-increasing takeovers shortly.

regulatory means[127], though such an argument would obviously be dependent a jurisdictions particular regulatory settings.

Ex-ante protection provided by mandatory bid rules may have additional positive flow-on effects, which serve to justify its imposition. Guaranteeing an early and individual exit option, at least to some degree with respect to partial takeovers in New Zealand, may make it more likely that investment will take place in code or widely held companies. While the substantive effect of this growth in trust cannot be measured exactly, it has been argued that they must be taken into account in any economic analysis to counter the burdening of the takeover process by the mandatory bid rule.[128] This is especially so since reliance on ex-post protection against abuse is uncertain or expensive.[129] Ex-ante protection of minority shareholders during takeovers can therefore reduce the cost of equity capital, increase the competitiveness for firms to be listed and may ultimately encourage entrepreneurial activity.[130]

B Arguments against mandatory bid rules

Arguments against mandatory bid rules draw heavily from efficiency enhancing motivations behind takeovers discussed previously, namely the potential for efficiency gains and the reduction of agency costs. The following section discusses these arguments.

1 An interference in the "market for corporate control"

A major criticism of the mandatory bid rule is that it constitutes an artificial interference in the market for corporate control. This market, and the reduction in agency costs within target companies it enables, functions effectively also without mandatory bids. Bidders can raise the bid price over the share price such that it corresponds exactly to the control premium of the controlling shareholder of the target company, and this price need not be shared with the minority shareholders.[131]

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[127] *Habersack*, above n 114, at 29-30.
[128] *Hopt*, above n 98, at 171.
[129] Ibid, at 170.
[130] Mike Burkart and Fausto Panunzi "Mandatory Bids, Squeeze-out, Sell-out and the Dynamics of the Tender Offer Process" (2003) Working Paper No 10/2003 ECGI Working Paper Series in Law [*Burkart and Panunzi*] at 7.
[131] *Hopt*, above n 98, at 168.

Theoretically at least, a mandatory bid rule has been shown to exacerbate likelihood of "holdout" problems, potentially substantially increasing the acquiring costs for potential bidders and discouraging takeover attempts.[132] This "holdout" problem was first articulated by Grossman and Hart.[133] Grossman and Hart consider a scenario when an outside buyer is considering whether to bid for control for a fully dispersed company where there is some cost associated with mounting a bid. Shareholders do not coordinate their response to the offer, and given the large number of shareholders, each shareholder rightly presumes that his decision has a negligible impact on the outcome of the tender offer. If the shareholder thinks that the offer will be successful and that the bidder will improve the firm, and hence the value of the shareholders' shares, the shareholder will retain their shares as they anticipate a price appreciation.[134] Since all shareholders act in the same manner, the offer can only succeed if the bidder offers at least the post takeover value. In such a scenario, the bidder clearly does not make a profit as there is some cost with mounting the takeover, meaning that a value increasing takeover is deterred due to the "free-riding" behaviour of shareholders. Specifically, while the success of the value-increasing takeover is a public good for the target shareholder, each individual shareholder prefers to hold out to extract the maximum gains, and as a result, value-increasing takeovers are not undertaken.[135]

The literature suggests there are several ways in which a bidder may overcome the free-rider problem. Grossman and Hart suggest that this problem can be overcome by withholding part of the post-takeover share value from minority shareholders. This creates a wedge between the post-takeover share value to the bidder and that to minority shareholders, enabling the bidder to make a profit and thereby enabling the value-increasing takeover in the first place.[136] Such a prescription is clearly at odds with the scheme of mandatory bid rules.

2 *Takeovers become more expensive*

While the arguments discussed above are largely theoretical, they dovetail nicely into a more practical criticism of mandatory bid rules, which is that they increase the costs of takeovers in general, and may deter takeovers.[137] To the extent such takeovers are value increasing in the sense they have the potential to achieve synergy gains, desirable takeovers may be deterred.

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132 Clas Bergström, Peter Högfeldt and Per Samuelson "The Regulation of Corporate Acquisitions: A Law and Economics Analysis of European Proposals and Reform" (1995) 2 CBLR 495 at 517 – 518.

133 See Sanford J Grossman and Oliver D Hart "Takeover Bids, the Free Rider Problem and the Theory of the Corporation" (1980) 11 Bell J Econ 42 [*Grossman and Hart*].

134 Ibid, at 43.

135 *Burkart and Panunzi*, above n 130, at 9-10.

136 *Grossman and Hart*, above n 133, at 43.

137 *Hopt*, above n 98, at 168.

In addition, increasing costs of takeovers may weaken the market for corporate control and the reduction of agency costs within target companies it entails.[138]

In relation to "strict" mandatory bid rules, such as that under rule 9 of United Kingdom's City Code, the implicit prohibition on partial bids makes control transactions more expensive for potential bidders.[139] In particular, "strict" mandatory bid rules may substantially increase the acquiring costs for a potential bidder by de facto raising the control limit to 100 percent, causing fewer takeover attempts. The increase cost in the form of higher interest expenses and greater exposure to risk can make it unprofitable for a bidder who has already identified improvements in efficiency to acquire control, replace management and change the production plan.[140] A "strict" mandatory bid rule can also prevent someone from acquiring a substantial position in order to learn more about the company and its development potential before going all the way to acquire control.[141]

Mandatory bid rules, whether "strict" or not, may also require bidders to offer a cash alternative when otherwise it would be free to make a wholly paper offer. In addition, fixing the price at which the acquirer must offer for the outstanding shares may expose the acquirer to adverse movements in the market between the acquisition of de facto control and the end of the offer period.[142]

The costs of mandatory bid rules are potentially much greater where there is concentrated ownership of listed companies, as is the case in New Zealand[143], than for acquisitions of control from dispersed shareholders. In this situation and under a mandatory bid provision, the acquirer no longer has the option of sticking with the control block it has purchased at a price acceptable to the seller. The bidder must extend that offer price to non-controlling shareholders as well. The bidder may well face the situation that it cannot pay the existing controller the price it wants to consent to the deal (reflecting private benefits of control) without overpaying for the company as a whole.[144]

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138 Ibid.

139 *The Anatomy of Corporate Law*, above n 1, at 233.

140 Clas Bergström, Peter Högfeldt and Johan Molin "The optimality of the Mandatory Bid" (1997) 13 J Law Econ & Org 433 at 438.

141 Ibid.

142 *The Anatomy of Corporate Law*, above n 1, at 228 – 229. Rule 24(2)(b) of the Code states that an offer period must be not shorter than 30 days, and not longer than 90 days. In addition, Rule 24C says that if the minimum acceptance conditions are satisfied or waived 7 days prior to the end of the offer period, the offer period is extend for 14 days from the day in which the minimum acceptance condition is satisfied or waived.

143 I discuss this feature under the Section V.

144 *The Anatomy of Corporate Law*, above n 1, at 233.

Where the private benefits of control are high, the disincentive effect of sharing of bid premiums may be significant. Fewer control shifts will occur, even where the acquirer intends to increase the operational efficiencies of the target. In countries where controlling shareholders are common, such as in New Zealand, this may be seen as a strong objection to the mandatory bid rule.[145] More generally, it has been found that takeover premium is higher in countries with higher shareholder protection.[146]

It should be noted that much of the discussion above is predicated on a "strict" mandatory bid, which raises the de facto control limit to 100 percent. While this is implicit under the full takeovers under rule 8 of the Code, rules 9 and 10 of the Code allow for partial offers. Under rule 10(1)(a), a bidder may make an offer for a specified percentage of shares over 50 percent and is obligated only to take up acceptances that grant them the specified percentage above the 50 percent threshold. In addition, rule 10(1)(b) allows a bidder to make an offer below 50 percent, although this first requires approval from shareholders other than the bidder for the takeover offer to proceed. If approval is granted for the takeover offer for a specified percentage less than 50 percent to proceed, the bidder is only obligated to take up accepted granting them their specified percentage. The allowance of partial offers therefore reduces the costs associated with extending the offer to all shareholders. Indeed, it has been noted that other takeover regimes have responded to concerns that "strict" mandatory bids may increase the costs of takeovers by not extending the rationale underlying the mandatory bid rule to a complete prohibition of partial general offers.[147]

Nevertheless, concerns that mandatory bid rules increase the cost of takeovers, potentially deterring efficiency enhancing takeovers, are not completely eradicated despite the allowance of partial offers under the Code. Obtaining approval from shareholders for a partial bid below 50 percent may be uncertain. A potential bidder may consequently opt for a specified percentage above 50 percent. Under such a scenario, an offer would likely need to be extended beyond the percentage required for effective control. Should there be concentrated ownership in the target company, a scenario likely in New Zealand, some premium reflecting private benefits of control may well need to be extended to non-controlling shareholders. This likely increases the costs of a takeover in comparison to a scenario where no mandatory provision was in place. Costs such as higher interest costs, exposure to risk, adverse movements in share prices and the need for a cash alternative if a wholly paper does not suffice would also equally apply.

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[145] Ibid.

[146] Stefano Rossi and Paolo Volpin "Cross-Country Determinants of Mergers and Acquisitions" (2004) 74 J Fin Econ 277 at 278.

[147] *The Anatomy of Corporate Law*, above n 1, at 229.

C Summary

As the above discussion demonstrates, arguments for and against mandatory bids are both persuasive, with no apparent consensus on which holds more weight. Arguments for mandatory bid provisions, such as reducing the pressure to tender, at least to some degree in New Zealand, especially where takeovers are motivated by factors other than potential for synergy gains and the reduction of agency costs within target companies, are persuasive. As are arguments that the guarantee of exit rights, to some degree in New Zealand, may incentivise investment in the first place reducing the cost of equity capital, increase the competitiveness for firms to be listed and may ultimately encourage entrepreneurial activity.

However, arguments that mandatory bid rules constitute an artificial interference in the market for control and make takeovers more expensive, deterring efficiency enhancing or value increasing takeovers, are also persuasive. While the allowance of partial bids in New Zealand mitigates the cost increasing effect to some degree, it is not completely eradicated.

Ultimately, the question of whether the benefits of the "weaker" form of the mandatory bid rules under the Code (i.e., the reduced pressure to tender for non-efficiency enhancing takeovers and the increased incentives to invest from ex-ante minority shareholder protection) outweigh the potential deterrence of efficiency enhancing or value maximising takeovers appears to be empirical. Indeed, whether the imposition of mandatory bid rules is beneficial is disputed and may ultimately be an empirical question. For instance, Bebchuk finds that neither a "market rule" (i.e., where minority shareholders enjoy no rights in connection with a sale-of-control transaction) and an "equal opportunity rule" (i.e., where minority shareholders are entitled to participate in the transaction on the same terms as the control seller) are dominant. A "market rule" enables more efficient transfers to take place but also allows some inefficient ones to take place. The "equal opportunity rule" prevents all inefficient transfers but is inferior in terms of facilitating efficient transfers.[148] Kahan comes to a similar conclusion and notes that the choice between the rules depend on the empirical question of whether social losses from undesirable control sales exceed social losses from deterring desirable control sales.[149]

As alluded to in the introductory remarks, this empirical question should not be divorced from the particular characteristics of New Zealand's listed equity markets. The following section discusses New Zealand's listed equity markets. As will become apparent, owing to

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[148] Lucian A Bebchuk "Efficient and Inefficient Sales of Corporate Control" (1994) 109 Q J Econ 957 [*Bebchuck*] at 959 – 960.

[149] Marcel Kahan "Sales of Corporate Control" (1993) 9 J Law Econ & Org 368 at 377.

certain factors, New Zealand does not appear to have conditions conducive to takeovers and therefore an active market for corporate control. This raises the question of whether the current rules under the Code in relation to takeover offers strike the right balance between discouraging inefficient takeovers and incentivising investment, and encouraging efficient takeovers.

V New Zealand's listed equity markets

A Small by international standards

New Zealand's listed equity markets are small by international standards.[150] Stock market as a ratio of gross domestic product ("GDP") stood at 40 percent in 2014, less than half that of Australia but similar to that of China and Germany at the time. This can be contrasted to the size of listed stock markets in the United States and Canada, which are over 100 percent of GDP, and the likes of Switzerland and Singapore, which are over 200 percent of GDP.[151]

More recent data indicates that New Zealand's listed equity markets still remain small by international standards. New Zealand's stock market capitalisation as a ratio of GDP in 2017 stood at 46 percent. While this is the highest since 2000, it still remains relatively small in comparison to other jurisdictions. For instance, Australia's stock market capitalisation as a ratio of GDP stood at 114 percent in 2017. The United States stood at 130 percent, Canada stood at 112 percent while the United Kingdom stood at 128 percent.[152] The likes of Switzerland and Singapore stood at 248 percent and 243 percent respectively.[153] As a recent survey notes that, while New Zealand's equity market capitalisation is at its highest level since 2000, it still is low by international standards.[154]

Other commentators have also noted the smallness of New Zealand's equity markets. Gaynor makes similar comparisons to larger economies such as the United States, Japan, China and India, noting the smallness of New Zealand's equity market in absolute terms in comparison to these countries. Gaynor further observes that we are also small in comparison to countries with similar populations. For instance, he notes that Singapore, with a population of 5.47

[150] Lauren Rosborough, Geordie Reid, and Chris Hunt "A primer on New Zealand's capital markets" (2015) 78 Reserve Bank of New Zealand Bulletin [*Rosborough, Reid and Hunt*] at 5.
[151] Ibid.
[152] JB Were "Equity Ownership Survey: New Zealand 2017" (2017) [*JB Equity Ownership Survey*] at 4.
[153] Statistics sourced from The World Bank "The World Bank – Data" < https://data.worldbank.org>.
[154] JB Were "Foreign Ownership Survey: New Zealand 2016" (2016) [*JB Foreign Ownership Survey*] at 1.

million people, Norway, with a population of 5.17 million and Ireland, with a population of 4.61 million, all have significantly larger stock exchanges in comparison to New Zealand.[155] Lastly, he notes that, given the smallness of its market, the New Zealand stock exchange is relatively illiquid[156], though it holds up reasonably well given the fact that a number of its larger companies are over 50 percent owned by the government or controlling shareholders.[157]

New Zealand's equity market size has fluctuated overtime as well, with no apparent trend for an increase or decrease in size either way. Its historic peak was in 1986, when stock market capitalisation to GDP was at 73 percent.[158] There was a dramatic fall in the size of New Zealand stock exchange from 1986, coinciding with the stock market crash in and around that time, specifically in 1987.[159] The size of the stock market peaked again in 1993, when stock market capitalisation to GDP was at 55 percent.[160] However, since then, there has been a general decline in the size of New Zealand listed equity markets, the lowest in and around the time of the global financial crisis, with the documented resurgence of late.

According to Rosborough et al, the comparative smallness of New Zealand's listed equity market is not a surprise. New Zealand has a low national savings rate. It also has high proportion of companies being wholly-owned offshore. Combined with the relatively low-capital intensive economy, they consider it understandable that New Zealand has a relatively small listed equity market.[161] Gaynor offers similar reasons as to why New Zealand has a relatively small listed equity market. He considers one explanation is that New Zealand's rural sector, the country's main economic engine, is under represented on the New Zealand stock exchange and because Fonterra, New Zealand's largest company, is a co-operative and is not fully listed. He also cites the reluctance of New Zealand business people to list their companies and the risk aversion of New Zealand investors, who prefer to invest in residential property and bank term deposits rather than equities. In particular he notes, drawing from Reserve Bank statistics, that New Zealanders had 719 billion dollars invested in residential

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[155] Brian Gaynor "Our small NZX and why liquidity matters" (28 March 2015) New Zealand Herald <www.nzherald.co.nz> [*Gaynor*].

[156] Liquidity refers to the ease at which shares can be traded. It usually refers to the speed at which shares can be traded and that it can be sold without materially affecting the market price (i.e., there must be sufficient demand to support the price during the course of the transaction. Liquidity may be important for traders looking for rapid sales in case the share price drops past a certain level but may not be so important for other investors – see, for example, Michael Kemp "Why share liquidity is so important" (May 2014) ASX <www.asx.com.au>.

[157] *Gaynor,* above n 155.

[158] Statistics sourced from The World Bank "The World Bank – Data" < https://data.worldbank.org>.

[159] Peter Fitzsimons "The New Zealand Securities Commission: The Rise and Fall of a Law Reform Body" (1994) 2 Waikato L Rev 87 [*Fitzsimons*] at 103.

[160] Statistics sourced from The World Bank "The World Bank – Data" < https://data.worldbank.org>.

[161] *Rosborough, Reid and Hunt*, above n 150, at 11.

property, 129 billion in bank deposits and only 25 billion dollars in direct domestic equities at the end of 2013.[162]

B *High levels of foreign ownership*

A second distinct feature of New Zealand's listed equity markets are the high levels of foreign ownership. Rosborough et al note that while domestic institutional holdings increased to just over 40 percent of ownership in 2014, with the emergence of the KiwiSaver scheme a possible explanation of the recent upswing, it remains low compared to many other countries, including Australia.[163] Drawing on data up till 2016, overall foreign ownership increased to 36 percent in 2016 from 32 percent in 2015.[164] A further iteration of the same survey observes a further 2 percent increase to 38 percent in 2017.[165] In comparison, the level of foreign ownership in countries such as the United States and Japan stands at 15 percent and 30 percent respectively. Foreign ownership is, however, higher in Australia at 50 percent.[166] The authors note that the high level of foreign ownership is not surprising given that the New Zealand market consists of a number of high quality, stable companies that, in many cases, pay attractive dividend yields.[167]

An explanation of the relatively high level of foreign ownership in the listed New Zealand listed equity markets may be a result of New Zealand's dependence on overseas capital. Historically, various authors have noted that New Zealand has been heavily, even "exceptionally" dependent on foreign investment.[168] The New Zealand Treasury has noted that "[i]n the early colonial period, foreign investment was as much as 273 percent of GDP".[169] As noted by Woolford, Reddell and Comber, throughout the 1990s, New Zealand's dependence on overseas capital increased considerably, with a renewed and substantial equity inflow at the time.[170] In 2000, the UN Conference on Trade and Development ranked New Zealand first in their "Transnationality Index", a measure based primarily on foreign direct investment flows.[171] This trend has not abated. As of the year ended March 2016, Australia

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162 *Gaynor*, above n 155.
163 *Rosborough, Reid and Hunt*, above n 150, at 11.
164 *JB Foreign Ownership Survey*, above n 154, at 1.
165 *JB Equity Ownership Survey*, above n 152, at 1.
166 Ibid.
167 *JB Foreign Ownership Survey*, above n 154, at 1.
168 See, for example, Bill Rosenberg, 'Foreign Investment in New Zealand: The Current Position' in Peter Enderwick (ed), Foreign Investment: The New Zealand Experience (Dunmore Press, 1998) and Michele Akoorie, 'The Historical Role of Foreign Investment in the New Zealand Economy' in Peter Enderwick (ed), Foreign Investment: The New Zealand Experience (Dunmore Press, 1997).
169 New Zealand Treasury, *International Investment for Growth* (October 2015) at 7.
170 Ian Woolford, Michael Reddell and Sean Combber "International capital flows, external debt, and New Zealand financial stability" (2001) 64 Reserve Bank of New Zealand Bulletin at 6.
171 United Nations Conference on Trade and Development "World Investment Report 2000: Cross-border Mergers and Acquisitions and Development" (2000).

was responsible for just over half (51.58 percent) of the stock of foreign domestic investment in New Zealand.[172]

The importance of foreign investment to New Zealand, and its dependence on it, has also been judicially recognised under a different context, namely under the authorisation regime of the Commerce Act 1986 ("the Commerce Act").[173] Under the authorisation regime of the Commerce Act, a merger or acquisition may be permitted, even if it results in a substantial lessening competition, if it results in such a "public benefit" that it should be permitted.[174] Benefits weighed against the competitive detriments from a substantial lessening of competition include productive efficiency gains from the merger[175], which may ultimately accrue to foreign shareholders. Gains accruing to foreign shareholders are not necessarily a "public benefit" as this term has been interpreted as being confined to effects on residents domiciled within New Zealand.[176]

However, the courts have recently upheld that productivity efficiency gains flowing to foreign owners from a merger should not be discounted in comparison to gains accruing to domestic shareholder as New Zealand seeks to be a member of a liberal multilateral trading and investment community.[177] The New Zealand Commerce Commission has noted that discounting productivity efficiency gains flowing to foreign shareholders could provide a disincentive for foreign investment. This in turn could be detrimental to the wider benefits the foreign investment provides New Zealand, such as a higher stock of available capital and lower cost of capital for the New Zealand economy, as well as improved technology and knowledge transfer.[178]

C Concentrated ownership

Another distinct feature of New Zealand's listed equity market is the high level of ownership concentration or block-holding. Various studies over time have emphasised that ownership concentration in New Zealand is high. A 2001 study, while concentrating on the efficacy of monitoring by the board of directors in New Zealand through its impact on firm performance,

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172 NZIER "Is peak globalisation upon us? Globalisation is much more than trade in goods" (2017) NZIER public discussion paper at 18-19.
173 Commerce Act 1986, s 67.
174 Ibid.
175 Commerce Commission "Authorisation Guidelines" (2013) at [36].
176 Ibid, at [54].
177 *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZHC 1262, [2016] 3 NZLR 645, [2016] NZCCLR 5 at [36].
178 *Cavalier Wool Holdings Ltd and New Zealand Wool Services International Ltd* [2015] NZCC 31 at [406] and [411].

also reported ownership concentration. The study had data on a sample of firms listed on the New Zealand Stock Exchange for the years 1991 to 1997. The concentration measure it employed was the proportion of shares held by the 20 largest shareholders of the firm. It found that on average, the 20 largest shareholders of the firms in the sample held 76.3 percent of all shares. The median figure found was 78.3 percent.[179]

A later 2008 study uses data from July 1999 to June 2004. Once again, while the focus of the study was different, they measure the sum of equity shares held by the top ten shareholders as a percentage of the total number of shares outstanding. In their sample, the authors find that a high fraction of the outstanding shares were held be large shareholders, with the mean shareholding equating to 64 percent.[180] Drawing on the aforementioned papers, another paper concludes that the level of block ownership is striking compared to other markets.[181]

A more recent study uses data for the top 50 publically listed companies on the New Zealand Stock Exchange for the period 1999 to 2007. There were a total of 410 firms included in the sample covering all sectors of the economy, including energy, goods, property, services and investments.[182] Once again, the concentration measure used was the proportion of shares held by the 20 largest shareholder of the firm. The mean proportion of stock held by the 20 largest shareholders found was 63 percent, while the median proportion was 65 percent.[183] The paper notes that although block-ownership in New Zealand had declined from an average of 76 percent during the 1991 to 1997 period to an average of 63 percent during the 1999 to 2007 period, it was still relatively high.[184] Finally, a later study, using data for the 2005 to 2010 period finds that the 20 shareholders held an average of 70 percent of the voting rights in New Zealand's publically listed companies.[185] The concentrated holding of the top 20 shareholders in New Zealand is in contrast to other jurisdictions. As noted by Reddy et al, in the United States and the United Kingdom, countries with similar financial systems to that in

[179] Mahmud Hossain, Andrew K Prevost and Ramesh P Rao "Corporate governance in New Zealand: The effect of the 1993 Companies Act on the relation between board composition and firm performance" (2001) 9 PBFJ 119 [*Hossain et al*] at 131

[180] Abeyratna Gunasekarage and Debra K Reed "The Market Reaction to the Appointment of Outside Directors: An Analysis of the Interaction between the Agency Problem and Affiliation of Directors" (2008) 4 International Journal of Managerial Finance 259 at 271.

[181] Bruce Burton, Abeyratna Gunasekarage and Jayanthi Kumarasiri "The influence of blockownership level and identity on board composition: evidence from the New Zealand market" (2013) 23 AFE 1287 at 1289.

[182] Krishna Reddy, Stuart Locke and Frank Scrimgeour "The efficacy of principle-based corporate governance practices and firm financial performance: an empirical investigation" (2010) 6 IJMF 190 [*Reddy et al 2010*] at 196.

[183] Ibid, at 200.

[184] Ibid.

[185] Krishna Reddy, Sazali Abidin and Linjuan You "Does corporate governance matter in determining CEO compensation in the publicly listed companies in New Zealand? An empirical investigation" (2015) MF 301 [*Reddy et al 2015*] at 314.

New Zealand, the fraction of the shares held by the controlling shareholder is only 20 percent and 10 percent in the top 20 United States and United Kingdom firms respectively.[186]

It should be noted that block-holding or concentrated shareholding may alleviate the need for an active market for corporate control as a corporate governance device, as managerial monitoring may be performed by block-holders themselves.[187] Countries with concentrated ownership may therefore be less in "need" to deploy pro-bidder takeover laws.[188] However, such an assumption may not hold in New Zealand, due to its high levels of foreign ownership, as discussed above. The geographical separation of large institutional investors from the companies they own stock in may reduce overall effectiveness in their ability and, or, willingness to monitor management. Indeed, this is one of the reasons offered as to why management is found to remain entrenched for a larger range in New Zealand than in the United States.[189]

D Summary

As the preceding discussion demonstrates, New Zealand's listed equity markets have distinct characteristics that may mean that it is not particularly conducive to takeovers, and therefore a market for corporate control.

The relative smallness of its stock exchange may mean that there is a lack of potential takeover targets in general. Indeed, the Capital Market Development Taskforce noted that that there may be a shortage of quality investment products, both in equity and debt markets. It notes that New Zealanders do not have as many opportunities to invest in large and mature local companies as do investors in many other countries. Gaps identified in the stock exchange include the fact that the agricultural sector, one of the largest sectors in New Zealand, is underrepresented, financial services businesses such as banks are mostly foreign-owned and do not raise equity in New Zealand's capital markets and that utilities have a high degree of central and local government ownership. The Capital Market Development Taskforce also notes that, at the time, a third of the largest 200 companies were listed,

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186 *Reddy et al 2010*, above n 182, at 200.
187 *The Anatomy of Corporate Law*, above n 1, at 238.
188 Ibid.
189 Gurmeet S Bhabra "Insider ownership and firm value in New Zealand" (2007) 17 J of Multi Fin Manag 142 at 144 and 152. Another reason provided for this finding is that listed companies in the period studied (1994 to 1998, that is, before the adoption of the Code), were required to adopt one of three anti-takeover charters, which the author considers had the effect of potentially constraining external disciplining through takeovers.

compared to around two thirds in Australia.[190] While this report is somewhat old, the lack of potential investment opportunities or takeover targets would appear to still ring true.

The dependence of foreign capital may also inhibit the incidence of takeovers. Faced with a choice of potential takeover targets in New Zealand and in their home jurisdictions that provide the potential for similar gains, familiarity with the home jurisdictions laws, markets and customs may mean costs of a takeover are seen as being relatively higher in New Zealand, deterring bids in the first place.

Finally, as discussed extensively in the literature, concentrated ownership is likely to raise the costs of takeovers. Controlling shareholders, reflecting private benefits of control, may demand a higher price to consent to a change in control. Under a mandatory bid rule, this higher price must be extended to non-controlling shareholders, which may deter such bids in the first place.[191]

The view that the particular characteristics of New Zealand's equity markets may not be conducive to takeovers and therefore the market for corporate control appears to be supported by a host of papers. Hossain et al suggest that the market for corporate control maybe weak in New Zealand due to its concentrated ownership structure, as control transfers can only take place with the consent of a limited number of large block-holders.[192] Mak and Li make a similar point in relation to the market for corporate control in Singapore, which is also characterised by high ownership concentration.[193] Other scholars suggest that New Zealand's small capital markets mean that the market for corporate control is inactive, going as far as concluding that it is virtually non-existent.[194] Others point to both the smallness of its capital markets and concentrated ownership in concluding that the market for corporate control is relatively weak.[195]

Before turning to assess whether New Zealand's mandatory bid rules strike the right balance between discouraging inefficient takeovers and incentivising investment, and encouraging

[190] Capital Market Development Taskforce "Capital Markets Matter: Summary Report of the Capital Market Development Taskforce" (2009) at 5.
[191] *The Anatomy of Corporate Law*, above n 1, at 233.
[192] *Hossain et al*¸ above n 179, at 131.
[193] Y T Mak and Yuan Li "Determinants of corporate ownership and board structure: evidence from Singapore" (2001) 7 Journal of Corporate Finance 235 at 238-239.
[194] *Reddy et al 2015,* above n 185, at 308.
[195] Allan Chang "Disclosure standards of large New Zealand companies: A content analysis study of compliance with the FMA's corporate governance guidelines" (2017) Occasional and Discussion Paper Series 5 at 2.

efficient takeovers, in light of the particular characteristics of its capital markets, it is useful first to assess whether such considerations where debated during the adoption of the Act and the Code. The following section provides an overview of the adoption of the Act and the Code with a particular focus on the debate for and against the adoption of a mandatory bid rule.

VI The debate during the adoption of the Code

A Securities Commission's initial proposals

It is safe to say that the implementation of takeover regulation in New Zealand, and the mandatory bid, has been controversial. Prior to the Act and the Code, the major statute on takeovers was the Companies Amendment Act 1963, which regulated the process of takeovers and was referred to as a "pause and publicity statute". It provided for a mandatory period of notice for a takeover and for details of the offer being given to shareholders of the target company where the takeover offer was in writing. It did not regulate oral offers or stands in the market. Nor did it control the price to be offered, require the equal treatment of holders of the same class of shares or a prohibition on partial bids.[196]

In 1981, the New Zealand Stock Exchange introduced a takeovers code into its listings. The code provided that all shareholders of the same class of shares were to be treated 'similarly' by the offeror, and required that subsequent offers to shareholders be made on "no less favourable terms" to prior offers made when a takeover was "reasonably in contemplation".[197] The code was seen as having a limited effect. Its sanctions applied only to listed companies. In addition, where a takeover took place in breach of the listing rules, a threat to delist the target company would harm the shareholders who had not taken up the offer. The code was consequently seen as largely ineffective, although its provisions were essentially the same as those proposed later in 1989 by the Securities Commission.[198]

The Securities Commission, established after the enactment of the Securities Act in 1978, made various proposals for reform in both primary and secondary securities markets in the decade after its establishment.[199] In 1983, the Securities Commission proposed reforms in

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[196] Peter Fitzsimons "New Zealand's Takeovers Regulation: The Unresolved debate" (1996) 3 Agenda: A Journal of Policy Analysis and Reform 317 [*Fitzsimons – The Unresolved Debate*] at 318.

[197] Ibid.

[198] Ibid.

[199] *Fitzsimons*, above n 159, at 91.

relation to takeovers, with the publication of investigations into particular transactions in three volumes.[200] Its proposals included, among others, requiring a formal offer to be made once twenty percent of a company's capital had been acquired, requiring the offeror to pay the same amount for each share acquired and that offer be extended to all holders of security of the class being bid for. Partial offers were recommended, so long as the offer was pro-rated.[201]

As noted by Farrar, the Securities Commissions recommendations received brutal treatment at the hands of the Treasury and the Reserve Bank.[202] In response to these recommendations, the Treasury noted:[203]

> [i]n all these ways the [Securities Commission's] proposals will make takeovers more difficult and costly, thereby reducing the incidence of takeover activity and increasing the degree to which management can be lax in its use of resources before facing this form of market discipline. This analysis is supported by empirical evidence showing that laws along these lines are associated with a substantial rise in takeover premia. The proposals would also make it much more difficult and costly to assemble substantial minority blocks of shares and to wage proxy contests for control. It is clear from the analysis of Sections II and III that laws implementing such proposals would significantly reduce both the incentive effects of potential takeovers and the real gains from such takeovers as do occur. They would also greatly reduce the effects of possible contests and the amount of monitoring associated with the holding of substantial minority blocks of shares. As a result, agency costs would be increased through reductions in monitoring of management teams and in the incentives of efficiency in management.

Drawing on a study that measured the average percentage gain for both shareholders of targets for takeover bid between 1968 and 1981, which found that there were an average gain of 28 cents for target shareholders and an average loss of 3 cents for bidder shareholders, the Treasury also commented that:[204]

> [t]he fact that most of the gains from takeovers accrue to the target shareholders is consistent with the hypothesis that, at least on the bidder's side, the market for takeovers is a competitive market. If this market were not competitive there would be supra-normal profits to be reaped, which would show up as increases in the bidders' stock price at the takeover event. The negative stock price movements from takeover activity may be lower then [sic] rates of return to other investment activities. Such findings are not inconsistent, of course, with the proposition that takeovers are, in general, value creating transactions.

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[200] Ibid, at 100.

[201] Peter McKenzie "Takeovers – The New Zealand Experience" in John Farrar (ed) *Takovers: Institutional Investors and the Modernization of Corporate Laws* (Oxford University Press, Auckland, 1993) 106 [*McKenzie*] at 113.

[202] *Farrar*, above n 112, at 312.

[203] *Fitzsimons*, above n 159, at 101.

[204] *Fitzsimons – The Unresolved Debate*, above n 196, at 320.

As the above extracts demonstrate, the risks that mandatory bid rules would make takeovers more costly and would therefore inhibit the market for corporate control and the benefits it brings were central to the debate at the time.

The Treasury response to the proposals garnered critiques of its own, with commentators arguing that the economic evidence it relied upon related mostly to takeover activity in the United States.[205] Nevertheless, it was clear from the reactions to the Security Commission's proposals that there was very little prospect of the government adopting its proposals without further theoretical underpinning.[206]

B 1986 to 1989

From the middle of 1986 towards the end of 1989, there was a notable change in the government's attitude towards regulation of the securities markets. This change in attitude appears to been brought about by the substantial increase in activity on the stock market, public outcry in relation to insider trading and the stock market crash in 1987.[207] In addition, McKenzie notes that there were a series of takeovers between 1986 and 1989 that led to detriment to minority shareholders that would have been avoided had there been a mandatory equal-price procedure.[208]

Examples of detrimental control transactions for minority shareholders include the acquisition of 35% of Nathan from Fay Richwhite by Lion and Nathan that resulted in Fay Richwhite receiving one and a half times the price paid to other shareholders. Also of note was the partial acquisition by Singaporean and Malaysian interests of London Pacific Limited in 1988. The purchase price was 19 cents per share. The highest price traded on the exchange throughout the preceding month was 11 cents per share. Almost immediately following the acquisition of control, some 33 million dollars of the funds of London Pacific Limited were invested in forestry rights which was owned by one of the parties involved in the acquisition. There was no return to shareholders in relation to this investment, and in October 1990, London Pacific Limited was placed in receivership and subsequently delisted.[209]

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205 *McKenzie*, above n 201, at 126 – 127.
206 Ibid, at 115.
207 *Fitzsimons*, above n 159, at 103.
208 *McKenzie*, above n 201, at 121.
209 Ibid, at 121-122.

In 1988, the Securities Commission produced a follow up report, settling upon the "pari passu" principle as the theoretical underpinning of its proposals, which were by and large the same as its 1983 recommendations.[210] The Minister of Justice publically announced that it had approved the recommendations for takeover legislation at the time.[211] However, due to companies law in general being reconsidered at the time, takeover regulation was delayed so as to be considered contemporaneously with company law reform.[212]

C 1990 to the Code's adoption

A new government was elected in 1990, and facing a substantial law reform agenda including company, securities and commercial law, it called in a committee of eight experts from which they sought advice.[213] Once again, the Securities Commission proposals regarding mandatory rules received criticism. The "Group of Eight" rejected the Securities Commission's approach, and did not consider there was an empirical analysis suggesting that the mandatory offer and equal price approach is the preferred regime to better achieve the government's growth objectives.[214]

While expressing appreciation for the work of the "Group of Eight", the government pushed ahead with takeover regulation and introduced a Takeovers Bill in 1991, which established a Takeovers Panel whose task it was to formulate a Takeovers Code.[215] In April 1993, shortly after the Takeovers Act 1993 was passed by Parliament, but before it had come into force, the Takeovers Panel Advisory Committee (a forerunner to the Takeovers Panel) produced a "Final Draft Takeovers Code" for the Government to consider.[216] As was the standard procedure in such cases, the government called for submissions on the formation of the Code. Key areas of contention included, as expected, the mandatory bid rule.[217] Once again, views on the code differed significantly, prominent amongst which was the New Zealand Business Roundtable ("NZBR") and the Institute of Directors ("IOD").[218]

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210 *McKenzie*, above n 201, at 115 – 116. For a critique of the Securities Commissions use of the "pari passu" principle as the basis of its recommendations, see *Farrar*, above n 202, at 315 – 317.
211 Ibid, at 106.
212 Ibid, at 118.
213 Ibid, at 119.
214 Ibid, at 119-120.
215 Ibid, at 120.
216 Alan Lowe and Juliet Roper "Share-market Regulation in New Zealand: The Problematisation of Takeover Legislation" (2000) 21 Policy Studies 115 [*Lowe and Roper*] at 120.
217 Sonja Gallhofer, Jim Haslam, Juleit Roper "Applying critical discourse analysis: Struggles over takeovers legislation in New Zealand" (2001) 8 Advances in Accountability: Regulation, Research, Gender and Justice 121 at 132.
218 Ibid.

The NZBR considered that costs associated with implementing the draft Code would likely be large as they would raise the costs of launching all takeover bids, thereby deterring all wealth-creating activities.[219] The NZBR considered that:[220]

> …the draft Code will severely damage the market for corporate control…by [amongst other things]…sheltering inefficient management and reducing company performance, share prices and productivity of resources.

The NZBR also considered that the effect of the mandatory bid rule in the New Zealand market would be to significantly reduce the attractiveness of its market to international investors, which it considered important given the recent growth of overseas investment in New Zealand. In particular, it stated that:[221]

> …the effect of the mandatory offer law in the New Zealand market would be to significantly reduce the attractiveness of this market to international institutional investors…overseas investment in the New Zealand market has grown enormously in recent years – in absence of the proposed regulations. We are aware of some research in the United States which finds that some forms of takeover regulation have depressed share prices.

The IOD's concerns largely reflected those offered in favour of the mandatory bid rule: the protection of minority shareholders. The IOD stated that it:[222]

> …confidently predicts that there will arise, perhaps, very quickly, a "takeover" situation in which, yet again, the non controlling investors will be severely disadvantaged and the unregulated market in respect of takeovers, will be vigorously exploited.

The IOD also pointed to the concentrated shareholding in New Zealand and noted that control of these companies could be transferred without any involvement by minority shareholders, in contrast to the position in the United States where control of a company is very seldom held by one player.[223] More generally, supporters of the Takeover Code argued that protection of minority shareholders would encourage investment in the stock market in the first place.[224]

Other arguments for mandatory bid rules drew on characteristics of New Zealand's stock markets. Drawing on the smallness of its economy and stock market, it was noted that New Zealand could not rely on shareholder litigation as a means of controlling directors (i.e., ex-post protection against exploitative behaviour of the acquirer following a takeover). It was argued that high costs of litigation, risk of an award of costs against the plaintiff and the small

[219] Ibid, at 133.
[220] Ibid, at 134
[221] Ibid, at 136.
[222] Ibid, at 136.
[223] Ibid, at 135-136.
[224] *Lowe and Roper,* above n 216, at 122.

size of New Zealand's listed companies did not justify litigation relating to the issue of corporate control.[225]

In spite of the presence of a draft Code, the government announced in September 1993 that the Takeovers Bill would be passed without the Code, meaning that any takeovers law could not be enforced. This Code would be held in abeyance until after the effectiveness of the new Companies Act in protecting minority shareholders could be measured.[226] Arguments for and against continued in the intervening period. Arguments against the Code stated that it would "reduce economic growth", "reduce efficiency", reduce the "international competiveness" and attractiveness" of the New Zealand market as well as severely "damaging the market for corporate control".[227] Supporters of the code pointed to numerous examples of where actual takeovers had been detrimental to minority shareholders and considered that protection of shareholders would "lower New Zealand's cost of equity capital".[228] Implicit in this latter argument was that protection of minority shareholders would incentivise investment in the first place.

In July 1995, the final version of the Code was presented, unchanged from the earlier draft, with the statement that "virtually all the changes of control [of companies] in the last 18 months have taken place without any participation by the majority of shareholders".[229] Despite this, the government was not convinced that a Code was necessary and "decided it would more appropriate for the Stock Exchange itself to manage the rules through its own procedures".[230] Ultimately, following a change in government from National to Labour in 1999, was the Code implemented.

D Summary

The debate surrounding the adoption of the Act and the Code spanned more than a decade. As is evident from the following discussion, much of the debate canvassed much of the substance of the empirical question posed throughout this paper. In addition, much of the arguments for and against the imposition of the mandatory bid rule followed those arguments discussed within academic circles.

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225 *Fitzsimons – The Unresolved Debate*, above n 196, at 324.
226 Ibid.
227 Ibid, at 123.
228 Ibid, at 124.
229 Ibid.
230 Hon Bill Birch "Labour Intent on Re-regulating New Zealand" (Press Release, 2 June 1999).

Arguments that the mandatory bid provisions proposed would increase the costs of takeovers, resulting in less value increasing takeover from taking place, were put forward by the Treasury as far back as 1985. Both the Treasury and NZBR also noted that this disciplining effect of takeovers may be inhibited, resulting in increased agency costs within target companies due to reduced market discipline on management. A reduction in the competitiveness of New Zealand's capital markets was also raised, in light of significant increase in investment from foreign investors at the time.

Arguments for mandatory bid drew on the concentrated nature of ownership in publicly listed companies and noted that a change in control could be effected without the involvement of minority shareholders. It was argued that the mandatory bid provisions, which would provide ex-ante protection to minority shareholders and a right to participate in a change of control, would also incentivise investment in the first place. Of importance to the debate were also instances of where takeovers resulted in significant losses to minority shareholders.

What is interesting is that, from the material reviewed, specific arguments around whether the proposed partial offer rules proposed were optimal for New Zealand at the time do not appear to have been discussed. As discussed during the course of setting out arguments for and against mandatory bid rules, partial bids act to reduce the "pressure to tender" to an extent, provide a degree of exit rights, and consequently incentivise investment and reduce, to an extent, costs associated with takeovers. However, given that the debate overseas centred on between the extreme position of a "strict" mandatory bid rule and market rule, it is understandable that the debate in New Zealand followed much the same lines.

Ultimately, the adoption of the Code represents, in effect, a view that the potential costs of the imposition of the mandatory bid rules within the Code (i.e., the potential discouragement of efficiency enhancing takeovers) were outweighed by the benefits mandatory bid rules would bring about (i.e., the discouragement of inefficient takeovers and incentivising investment). However, while this view may have held at the time of the adoption of the Code, it does not preclude a reassessment in light of the current conditions and characteristics of New Zealand's listed equity markets. The next section draws the discussion in this paper to a close and assesses whether the New Zealand's mandatory bid rules are fit for purpose.

VII Discussion

A The discussion so far

Up to this point, the most uncontroversial statement to make would be to say that mandatory bid rules are controversial. Whether or not to impose rules obliging that an offeror or bidder, who seeks control of a publically listed or widely held company, to extend that offer to all shareholders in that company generates heated arguments either way.

Arguments for and against mandatory bid rules can be seen as, to a large degree, a consequence of the varying motivations behind takeovers. Takeovers can be motivated by potential synergies, such as economies of scale or scope, or financial synergies. One of the central reasons why any restrictions on takeovers are viewed negatively relate to the market for corporate control. Agency costs within target companies may exist between shareholders on the one hand and managers on the other. Managers may have better information on the operations of companies, creating the chance for managers to act opportunistically to promote their interests as opposed to shareholders. In addition, monitoring of managers by shareholders may be costly, and maybe even more so the more complex the task managers' carryout. However, the threat of takeovers, and the potential loss in employment and reputation, where bidders identify potential gains from better or more efficient management, may incentivise managers to act in the interests of their shareholders in the first place and promotes economic efficiency in general. There is empirical evidence of supporting efficiency enhancing rationales behind takeovers.

However, takeovers may also be motivated by reasons other than efficiency. Managers may simply be motivated by notions of "self-aggrandizement" and "empire building", or simply may benefit form excess cash flow at the time. Managers may also overestimate their ability to judge value maximising takeovers and pursue them even if market evidence suggests that they should not. Once again, empirical evidence is also corroborative of such motivations behind takeovers.

Arguments against mandatory bid rules draw upon the efficiency rationales behind takeovers. It is argued that mandatory bid rules constitute an artificial interference in the market for corporate control and the reduction in agency costs within target companies it usually entails. A central argument against mandatory bid rules is that it makes takeovers more expensive and consequently deters efficiency enhancing takeovers.

Arguments for mandatory bid rules, by in large, draw on takeovers that may be motivated by reasons other than efficiency. Mandatory bid rules deter the "pressure to tender" for shareholders, allowing them the ability better judge whether a takeover is value increasing or not. Mandatory bid rules also provide shareholders ex-ante protection against takeovers that are motivated by offerors or bidders seeking to exploit private benefits of control. Such protections therefore may further incentivise investment to the benefit of capital markets in general. Ultimately, the question of whether mandatory bid rules are beneficial is seen as empirical by some scholars.

This empirical question cannot be divorced from the characteristics of the capital markets where mandatory bid rules are imposed. New Zealand's listed equity markets are small by international standards, characterised by a dependency on foreign investment and concentrated ownership. These characteristics suggest that there may be a lower incidence of takeovers in general, suggesting that the market for corporate control may not be as effective. The debate preceding the adoption of the Code and its mandatory bid rules, spanning more than a decade and encompassing much of the academic debate on mandatory bids, can be seen as ultimately considering that the benefits outweighed the costs.

B New Zealand's mandatory bid rules: Fit for purpose?

While the arguments for and against mandatory bid rules are informative, as noted previously, they do not apply absolutely to New Zealand. In fact, it has been noted that the assessment of partial offers has not attracted as much attention as market rules and "strict" mandatory bid rules, in part because the two most influential economic powers (i.e., the United States and the European Union) utilise distinct regimes that occupy the two extremes of the spectrum and take up most of the spotlight. [231]

New Zealand permits partial takeovers. An offer for over 50% but less than all shares may be made, conditional on the offeror obtaining over 50% of acceptances.[232] The offeror is not obligated only to take up acceptances up to their specified percentage, as excess acceptances will be scaled back proportionally.[233] An offer for less than 50% may be made, so long as shareholders other than the offeror consent to such an offer going ahead in the first place.[234]

231 Yueh-Ping (Alex) Yang and Piin-Hsien (Peggy) Lee "Is Moderation the Highest Virtue? A Comparative Study of the Middle Way of Control Transaction Regimes" (2017) 41 Del J Corp L 393 [*Ping and Piin-Hsien*] at 407.

232 Takeovers Code 2001, r 10(1)(a).

233 Takeovers Code 2001, rr 12 and 13.

234 Takeovers Code 2001, r 10(1)(b).

In addition, unlike the United Kingdom's city code, no prior approval from the New Zealand Takeovers Panel is required for such partial offers.

The allowance of partial takeovers under the Code is therefore likely to reduce the costs associated with launching a takeover offer. A prospective offeror or bidder is not obligated to extend the offer to all shareholders if they opt not to do so. An offeror may also opt to acquire just enough shares to acquire control (i.e., a specified percentage less than 50%) so long as they incur the marginal cost of extending a preliminary vote on whether such a takeover should take place or not. Indeed, the allowance of partial bids is recognised as a way of responding to concerns that mandatory bid rules may have a chilling effect on value increasing takeovers.[235] While, as noted previously, there may be uncertainty as to whether the preliminary vote to allow an acquisition of a specified percentage below 50% will be successful or not, it has the advantage of providing target shareholders an undistorted vote on the merits of the takeover offer in isolation.

Kraakman et al point to Italy as an example of a country that has allowed partial bids as a way of responding to the chilling effect of mandatory bid rules.[236] Italy permits partial bids for at least 60 percent of shares, provided that a majority of shareholders other than the offeror and connected persons approved the offer and the offeror has not acquired more than 1 percent of the shares over the preceding 12 months.[237] The allowance is in substance similar to rules set out in New Zealand for a partial offer for a specified percentage less than 50 percent.

Italy is described as having an ownership structure and the presence of financial actors that are almost opposite to the situation found in the United Kingdom, and at first blush, appear remarkably similar to that present in New Zealand. In particular, controlling shareholders in Italy, often an individual or family, usually owns significantly more than 30 percent of the voting shares, the control threshold in Italy. Institutional investors are found to have a growing, but marginal role, and tend to be quite passive when it comes to corporate governance.[238] Specifically, the largest shareholder tend to own, on average, 48 percent of shares.[239] In line with these characteristics, Italy has been found to have high levels of private benefits of control internationally, a factor which in combination with a "strict" mandatory

[235] *The Anatomy of Corporate Law*, above n 1, at 229.
[236] Ibid.
[237] Ibid, at fn 152.
[238] Marco Ventoruzzo "Takeover Regulations as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe" (2008) 11 U Pa J Bus L 135 at 154.
[239] Ibid, at 142.

bid rule, would be seen as having the effect of deterring takeovers in general.[240] Italy's listed capital market also appears to be relatively small internationally. Italy's stock market capitalisation as a proportion of GDP stood at 27 percent in 2014. In comparison, New Zealand's stock market capitalisation as a proportion of GDP stood at 37% that same year.[241]

Another jurisdiction Kraakman et al point to is Japan. Japan permits general offers up to two-thirds of the shares via a tender offer to all shareholders or market purchasers.[242] As noted by other authors, such a rule is fundamentally different to the "strict" mandatory rule in the United Kingdom, as it allows an acquirer to succeed in taking control of a target company without having to incur the costs of making a United Kingdom-style mandatory bid.[243] The characteristics of Japan's listed market are, however, distinct to those broadly found in New Zealand and Italy. It is characterised by dispersed ownership and depressed share values, factors which would suggest a takeover friendly environment.[244]

Nevertheless, hostile takeovers are rare in Japan. The lack of hostile takeover activity has been attributed to the fact that most listed companies in Japan contain a subset of "stable shareholders" (typically banks, insurance companies or other non-financial companies) that are typically engaged in business transactions with issuer companies, and have not purchased shares for the purpose of receiving dividends or realising gains, meaning such shareholders have little incentives to sell when faced with a takeover bid. On the contrary, they have a strong incentive to support incumbent management to maintain a solid business relationship with the issuer corporation.[245] While the concentration of holdings of "stable shareholders" has dropped recently, it has largely dropped in larger companies meaning that stable-shareholdings still remain relatively high in small and medium sized listed companies.[246] Other factors explaining the lack of hostile takeovers include cultural factors such as the reticence of all of Japan's major shareholders towards hostile takeovers.[247] One can draw the

240 Christophe Clerc, Fabrice Demarigny, Diego Valiante and Mirzha de Manuel Aramendia "A Legal and Economic Assessment of European Takeover Regulation" (2012) The Centre for European Policy Studies [*Clerc et al*] at 54.

241 Statistics sourced from The World Bank "The World Bank – Data" < https://data.worldbank.org>.

242 *The Anatomy of Corporate Law*, above n 1, at fn 152.

243 Dan W Puchniak and Masafumi Nakahigashi "The Enigma of Hostile Takeovers in Japan: Bidder Beware" (2018) 15 Berkeley Bus L J 4 at 26.

244 Ibid, at 6.

245 Ibid, at 17-18.

246 Ibid, at 19.

247 Ibid, at 38-39. In particular, it has been argued that all of Japan's large listed companies recruit their employees from top Japanese universities and provide them an implicit promise of a job until retirement. The economic fate of lifetime employees is tied to the economic fate of their companies, creating an important sense of group identity among lifetime employees and loyalty to their companies. Importantly, the most skilled lifetime employees are "promoted" to the board of directors, meaning boards of listed companies are dominated by lifetime employees who have a clear cultural bias against hostile takeovers. This culture is shared by most shareholders as they themselves tend to be lifetime employees.

inference that the allowance of partial bids in Japan is motivated by the responding to the difficulty in mounting a successful takeover in Japan, as Kraakman et al do.

Recent work also suggests that partial pro-rata offer rule, such as the partial offer rules in New Zealand may be a decent compromise between a "strict" mandatory bid rule and a market rule. A partial pro-rata offer rule may be just as effective as deterring value decreasing transactions as a "strict" mandatory bid rule. The intuition is as follows. An incumbent controlling shareholder is not guaranteed complete exit since, as long as minority shareholders tender shares, a controller can only sell part of its shares in accordance to a pro-rata rule.[248] The incumbent, knowing that their remaining shares may be subject to looting by the acquirer, will ask for compensation when selling their controlling block. Such compensation, due to the pro-rata rule, will further apply to other non-controlling shareholders. Ultimately, whatever amount of private benefit the acquirer sought to loot from the target will be returned to the target's shareholders during the acquisition, rendering any incentive to loot meaningless.[249] As alluded to earlier, partial pro-rata rules also impose less costs on acquirers for takeovers, since funding for the specified percentage required for control is only required.[250]

However, the partial pro-rata offer is not unambiguously better than a market rule. A market rule is said to permit more efficient transactions in the market than a partial pro-rata rule, although, it also permits more inefficient transactions as post-acquisition private benefits of control become relevant once again as a motivation behind takeovers.[251]

On balance, New Zealand's mandatory bid provisions seem appropriate given the characteristics of its capital markets. A small relative capital market, dependency on foreign investment and concentrated ownership means the incidence of takeovers in general may be lower and lead to a less effective market for corporate control. In such a scenario, a takeover regime should be aware of not increasing the cost of takeovers significantly. By and large, the Code's allowance of partial offers operates to ensure costs of takeovers are not significantly increased. A partial takeover specifying for a specified percentage less than 50 percent may be made, so long as shareholders other than the offeror consent to such an offer going ahead in the first place.

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248 *Ping and Piin-Hsien*, above n 231, at 427.

249 Ibid, at 429. See also *Bebchuck*, above n 148, at 969-970.

250 Ibid, at 430. It has been argued that under a "strict" mandatory bid rule, acquirers could simply borrow funds required an acquisition as long as they can persuade others to be optimistic of their acquisition plans. However, funding through loans or other debt vehicles may require higher aggregate interest expenses. Even if an acquirer uses its own capital, there may be an opportunity cost in doing so.

251 Ibid, at 432-433.

In addition, not all takeovers, even in countries such as New Zealand where market conditions arguably lower the incidence of takeovers in general, are motivated by efficiency considerations or the reduction of agency costs within target companies. Past experience in New Zealand is illustrative of the fact that some takeovers may be motivated by private benefits of controls, or be simply as a result of "empire building" or managerial "hubris". In such a scenario, a takeover regime should design rules so as to ensure such takeovers are deterred. Again, on balance, the Code's allowance of partial bids serves to address such a need. Importantly, it reduces the "pressure to tender" to an extent and allows target shareholders to assess the merits of an offer independent of whether or not to accept the offer. Finally, the benefits of providing some degree of exit right and ex-ante protection, in incentivising investment, which the Code's rules on partial offers provide, should not be understated.

VIII Conclusion

Mandatory bid rules are controversial, with extensive debate for and against its imposition. Ultimately, the question of whether it is beneficial or not is seen as an empirical one. This paper has argued that such a question cannot be divorced from the characteristics of the capital markets in which such a rule is imposed.

New Zealand's capital markets are small by international standards, are dependent on foreign investment and characterised by concentrated ownership. These characteristics suggest that the incidence of takeovers may in general be lower, which in turn suggests that its takeover regime should be wary of increasing the costs of takeovers, notwithstanding the benefits a mandatory bid rule may provide. This paper finds that New Zealand's mandatory bid rules, owing to the allowance of partial bids, largely responds to this concern and appears to be appropriate given the characteristics of New Zealand's capital markets.

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