



TAKEOVERS PANEL

**THE CODE AND DEFENSIVE TACTICS –
PROPOSED GUIDANCE NOTE**

**A CONSULTATION PAPER ISSUED BY
THE TAKEOVERS PANEL**

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3 July 2012

Introduction

1. A defensive tactic in relation to a takeover is any action that is taken or permitted by the target company that could frustrate a takeover offer or deny the shareholders of the target company the opportunity to consider the merits of a takeover offer.
2. The Panel proposes to issue a Guidance Note on the rules in the Takeovers Code (the “Code”) that relate to defensive tactics by target companies.
3. The rules in the Code that relate to defensive tactics by target companies are rules 38 and 39. Rule 38 of the Code prohibits a target company from engaging in defensive tactics in response to a takeover offer. Rule 39 sets out the circumstances in which a target company is permitted to engage in conduct that would otherwise be prohibited as a defensive tactic under rule 38.
4. Part One of this Consultation Paper discusses problems with the interpretation and application of rules 38 and 39 of the Code. Part Two of this Consultation Paper contains the Panel’s draft Guidance Note.

Request for comments on this paper

5. The Panel invites submissions on the draft Guidance Note. The closing date for submissions is **Friday, 10 August 2012**.
6. Submissions may be sent to the Panel:
 - (a) By email to takeovers.panel@takeovers.govt.nz.
 - (b) By post to:

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WELLINGTON
 - (c) By fax to (+64) 04 815 8459.

Official Information Act 1982

7. Any submissions received are subject to the Official Information Act 1982. The Panel may make submissions available upon request under that Act. If any submitter wishes any information in a submission to be withheld, the submission should contain an appropriate request (together with a clear identification of the relevant information and the reasons for the request). Any such request will be considered in accordance with the Official Information Act 1982.

Problem Identification

8. Rule 38(1) of the Code prohibits the directors of a Code company (the “target company”), once the company has received a takeover notice or has reason to believe that a bona fide offer is imminent, from taking or permitting any action, in relation to the affairs of the company, that could effectively result in:
 - (a) a takeover offer being frustrated; or
 - (b) the shareholders in the target company being denied an opportunity to decide on the merits of a takeover offer.
9. Based on the experience of the Panel and the Australian Takeovers Panel, the following are examples of the actions that could be used by the directors of a target company to resist a takeover offer:
 - (a) Acquiring or disposing of a major asset;
 - (b) Incurring a significant new liability or making a significant change to an existing liability;
 - (c) Declaring an abnormally large or unusual dividend or other form of capital distribution;
 - (d) Significant issues of new shares or repurchases of existing shares, or significant issues of convertible securities;¹
 - (e) Entering an agreement with a third party that confers significant economic benefits on the target company which are only available to one particular bidder.²
10. Nothing prevents the directors of a target company from taking steps to encourage competing bona fide offers from other persons.³
11. Rule 39 provides that the directors of the target company may take or permit the kind of action that would otherwise be prohibited by rule 38(1) in the following circumstances:
 - (a) *the action has been approved by an ordinary resolution of the target company; or*
 - (b) *the action is taken or permitted under a contractual obligation entered into by the [target] company, or in the implementation of proposals approved by the directors of the target company, and the obligations were entered into, or the proposals were approved, before the [target] company received the [relevant] takeover notice, or became aware that the [relevant] offer was imminent; or*
 - (c) *if paragraphs (a) and (b) do not apply, the action is taken or permitted for reasons unrelated to the offer with the prior approval of the Panel.*
12. Rule 40 of the Code sets out the requirements for the notice of meeting in respect of the ordinary resolution for the purposes of rule 39(a).

¹ Australian Takeovers Panel *Guidance Note 21: Frustrating Action* (6 May 2011), paragraph 1.

² *Determination – Tranz Rail* (6 August 2003), paragraph 46.

³ Rule 38(2) of the Code.

13. The purpose of rule 38(1) is to prevent the directors of a target company from taking steps to improperly resist a takeover offer for the company.
14. Rule 38(1) does not describe the specific kinds of actions taken or permitted by a target company that are prohibited as defensive tactics. The rule captures conduct that *could effectively* defeat a takeover offer. This is a broad expression and focuses on the potential outcome of the action taken or permitted by the directors of the target company, regardless of their intentions. Moreover, the conduct does not need to *actually* lead to the offer failing or not proceeding in order to meet the threshold of being a defensive tactic.
15. The broad application of rule 38(1) causes uncertainty for the directors of a target company.
16. The Panel has noted that a particular cause for concern is the restrictions put on the business activities of the target company by the conditions stipulated in a takeover offer by an offeror. A takeover offer usually includes conditions which protect the offeror from completing the offer if there are significant changes to the target company's business once the offer is made (for example, an offer condition may restrict the target company from entering into a major transaction).⁴ If the target company directors take or permit any action that could trigger a condition in the offer, the directors will risk contravening rule 38(1). To trigger a condition that entitles the offeror to not proceed with the offer could effectively result in the shareholders in the target company being denied an opportunity to decide on the merits of a takeover offer.
17. Rule 39 sets out the circumstances under which an action that would otherwise be prohibited by rule 38(1) is permitted. The Panel has noted that the provisos to rule 38(1) in rule 39 are also a source of uncertainty for the directors of target companies. The three provisos – shareholder approval, pre-existing obligations, and approval by the Panel – are expressed as alternatives.
18. In cases where the approval of the Panel is sought under rule 39(c), the Code does not contain the grounds on which the Panel may give approval. This contributes to further uncertainty for target company directors, their legal advisers, and the Panel itself.

Reasons for a new Guidance Note

19. One of the Panel's functions is to promote public understanding of the law and practice relating to takeovers.⁵ To this end, the Panel wants to ensure that directors of target companies understand the risks that arise under rule 38(1) of the Code and to clarify the Panel's jurisdiction under rule 39(c) of the Code, as well as minimising the costs of undertaking transactions under the Code.

⁴ The Panel has previously given guidance about restrictive conditions in offers: see *Guidance Note – Restrictive Conditions* (May 2006).

⁵ Takeovers Act 1993, section 8(1)(f).

20. To date, the Panel has made the following statements in relation to the defensive tactics rules in the Code:
 - (a) Guidance Note - Restrictive Conditions: The Panel has previously published guidance on the implications of offer conditions that restrict the business activities of the target company. The Guidance Note states that if an offer is conditional on specified events occurring or not occurring, and the target company directors take action relating to the target company which means a condition cannot be satisfied, the action by the directors could arguably be seen as a defensive tactic. However, if a condition is so restrictive that it restricts the target company from undertaking activities that are part of its ordinary business, which the target company would inevitably breach, the Panel's view is that such a condition is likely to breach rule 25(1). Rule 25(1) prohibits the offeror from including conditions which are within the offeror's control.
 - (b) Section 32 Determinations: The Panel has made comments on the Code's defensive tactics rules in several of its determinations under section 32 of the Takeovers Act 1993. These determinations form part of a body of jurisprudence on the defensive tactics provisions of the Code.
21. In addition to these public statements, the law and practice in Australia, as a comparable jurisdiction, can provide additional guidance to the Panel and market participants in New Zealand. In particular, the Australian Panel's Guidance Note *Frustrating Actions* is a useful comparative resource on matters involving defensive tactics.
22. The benefit of this body of existing knowledge lies in the direction it gives to directors, their advisers, and the Panel itself. When new issues arise in relation to defensive tactics, it provides a useful guide for decision-making.
23. The Panel is also proposing changes to the Code that, should they become law, will mitigate some of the risks that arise for directors of a target company under rule 38(1) as a result of restrictive conditions in a takeover offer. The Panel is proposing:
 - (a) To prohibit an offeror from relying on or invoking conditions of the offer that restrict the target company from carrying out its ordinary business; and
 - (b) To prohibit an offeror from unreasonably relying on or invoking a condition of an offer.
24. The Panel expects that these amendments will relieve the directors of the target company of potential non-compliance with rule 38(1) of the Code in respect of actions that were not genuinely defensive tactics.
25. However, another problem is that there are no public statements from the Panel (determinations or guidance notes) on the provisos to rule 38(1) that are contained in rule 39 of the Code. For instance, there is no guidance on the Panel's jurisdiction to approve defensive tactics under rule 39(c) of the Code. The Panel has not published any of its decisions under this rule. Accordingly, there may be a lack of public understanding about the Panel's jurisdiction and the grounds on which it may grant

approval of a defensive tactic. This contributes to uncertainty in the market.

26. The Panel's view is that a Guidance Note on defensive tactics would address these gaps and improve public understanding of the Code.
27. A draft of the Guidance Note on defensive tactics is **attached** for consultation. The Panel invites interested parties to make submissions on the draft Guidance Note. To assist with submissions, the draft Guidance Note contains a number of questions for submitters to consider.

DRAFT GUIDANCE NOTE

Submitters are invited to consider the questions set out in the questions boxes.

Defensive Tactics

1. This guidance note has been prepared to assist market participants to understand the Panel's approach when the directors of a target company engage in, or permit, defensive tactics in relation to a takeover offer or potential takeover offer.
2. This Guidance Note addresses:
 - (a) The implications of the Code's rules on defensive tactics for directors of target companies (or Code companies that could become target companies); and
 - (b) The grounds on which the Panel may exercise its jurisdiction to approve an action being taken or permitted by a target company that would otherwise be prohibited as a defensive tactic.

Question 1:
Should the Guidance Note address any other issues?
If so, please provide your suggestions and reasons.

Meaning of defensive tactics

3. A defensive tactic under the Code is any action that is taken or permitted by the directors of a target company, once the company has received a takeover notice or has reason to believe that a bona fide offer is imminent, in relation to the affairs of the Code company, that could effectively result in:
 - (a) a takeover offer being frustrated; or
 - (b) the shareholders in the target company being denied an opportunity to decide on the merits of a takeover offer.⁶
4. The Code does not describe the specific kinds of actions taken or permitted by a target company that are prohibited as defensive tactics. However, the following are examples of actions could be used by the directors of a target company to resist a takeover offer:
 - (a) Acquiring or disposing of a major asset;
 - (b) Incurring a significant new liability or making a significant change to an existing liability;
 - (c) Declaring an abnormally large or unusual dividend or other form of capital distribution;

⁶ Takeovers Code, Rule 38(1).

- (d) Significant issues of new shares or repurchases of existing shares, or significant issues of convertible securities;
 - (e) Entering an agreement with a third party that confers significant economic benefits on the target company which are only available to one particular bidder.⁷
5. This list is not exhaustive.

Question 2:

What other kinds of transactions could be used to defeat a takeover offer?

Please provide an explanation of the risks that the transaction could pose.

Do you have any other comments on the kinds of transactions that can be used as defensive tactics?

6. The extent to which an action *could effectively* result in an offer being frustrated or the shareholders being denied an opportunity to consider it, will depend on the circumstances of each case. It would not be a defensive tactic for the directors of the target company to provide genuine choices to the offeror or the offerees. For example, a transaction that might otherwise be a defensive tactic could be made conditional on the takeover offer not succeeding, or it could be conditional on the approval of the offeror.
7. Nothing prevents the directors of a target company taking steps to encourage competing bona fide takeover offers from other persons.⁸
8. The Panel does not consider that it is a defensive tactic if the directors of the target company, with good reason to do so, recommend that an offer be rejected.⁹
9. Frustration of a takeover offer does not relate to the legal doctrine of frustration. Rather, frustration for the purposes of the Code simply means a commercial impediment.¹⁰

Restrictive conditions in offers

10. The conduct does not need to *actually* lead to the offer failing or not proceeding before it would be considered to be a defensive tactic.
11. This can be a cause of particular concern to the directors of a target company in relation to the restrictions put on the business activities of the target company by the conditions stipulated in a takeover offer by an offeror. If the target company directors take or permit any action that could trigger a condition in the offer, the directors will risk contravening rule 38(1) of the Code. To trigger a condition that entitles the offeror

⁷ Takeovers Panel *Tranz Rail Section 32 Determination* (6 August 2003), paragraph 46.

⁸ Takeovers Code, Rule 38(2).

⁹ The target company statement must contain either a recommendation by the directors of the target company to accept or reject the offer and the reasons for the recommendation, or a statement that the directors of the target company are unable to make, or are not making, a recommendation and the reasons for not making a recommendation: clause 15(1), Schedule 2, Takeovers Code.

¹⁰ Takeovers Panel *Tranz Rail Section 32 Determination*, paragraph 48.

to not proceed with the offer could effectively result in the shareholders in the target company being denied an opportunity to decide on the merits of a takeover offer.

12. If a condition is so restrictive that it restricts the target company from undertaking activities that are part of its ordinary business, which the target company would inevitably breach, such a condition is likely to breach rule 25(1) of the Code. Rule 25(1) prohibits the offeror from including conditions which are within the offeror's control.

Question 3:

Do you think that this guidance will assist directors of target companies with understanding their options under rule 39? If so, why? If not, why not?

Provisos

13. The prohibition against defensive tactics is subject to three provisos. These are discussed below.

Proviso (a): resolution of shareholders

14. The directors of the target company may take or permit the kind of action that would otherwise be prohibited if the action has been approved by an ordinary resolution of the target company.¹¹
15. This proviso in the Code exists independently of any other regulatory requirements that may apply to the target company in respect of meetings of shareholders, such as the Companies Act 1993 or the NZX Listing Rules.
16. In some cases, a target company may prefer to seek the Panel's approval of the action under rule 39(c) rather than convene a meeting of shareholders. This is discussed in more detail below.
17. Rule 40 of the Code sets out the Code's requirements for the notice of meeting in respect of the ordinary resolution. The Panel considers that all the information required by rule 40 should be provided in the same place in the notice of meeting or in a document accompanying the notice of meeting, and should be in a form that can be readily understood by an ordinary shareholder.¹² The resolution must be prospective. The Panel considers that it is not possible for a rule 40 resolution to retrospectively approve the actions of directors.¹³

Proviso (b): Pre-existing obligation or proposal

18. It is not a defensive tactic if the action is taken or permitted under a contractual obligation entered into by the target company, or in the implementation of proposals approved by the directors of the target company, and the obligations were entered into, or the proposals were approved, before the target company received the takeover notice, or became aware that the offer was imminent.

¹¹ Takeovers Code, Rule 39(a).

¹² Takeovers Panel *Section 32 Determination Otago Power Limited* (31 May 2002), paragraph 46.

¹³ *Ibid*, paragraph 46.

19. This proviso is strict in its application. It does not extend to on-going negotiations or agreements or arrangements in principle to which the target company may be a party.

Proviso (c): Panel approval

20. If provisos (a) and (b) do not apply, the Panel has jurisdiction to approve an action that would otherwise be prohibited as a defensive tactic if the action is taken or permitted for reasons unrelated to the offer.
21. In some cases, the Panel's approval under rule 39(c) may be sought by a target company as an alternative to the shareholder approval proviso under rule 39(a). The Panel's jurisdiction is limited to approval of actions that are unrelated to the offer and the Panel is reluctant to "stand in the shoes of" shareholders if a decision would be more appropriately made by them.
22. In practice, this will mean that an application under rule 39(c) will need to demonstrate why shareholder approval of the action under rule 39(a) is not appropriate in the circumstances of the case. The inconvenience and cost of a meeting of shareholders, or that a commercial opportunity may be lost if it requires the approval of shareholders, may not be good reasons.
23. The Panel will consider all the circumstances of the particular case when it considers whether to approve an action under rule 39(c). Factors that the Panel may consider include (this is not intended to be an exhaustive list):
- (a) The circumstances that would lead to the particular action being taken or permitted;
 - (b) The timing of the takeover offer for the target company;
 - (c) The effect that the action may have on the offer (or any potential offer); and
 - (d) The effect of the action on the financial position or the business nature of the target company.

Question 4:

Are there any other factors that the Panel should consider under rule 39(c)? If so, please explain.

Question 5:

Are there any matters on the rule 39 provisos on which the Panel should comment further? Please explain why.

24. Actions that are likely to be unrelated to the offer may include:
- (a) An action in response to an extraordinary legal, political, or economic imperative, such as a government intervention or a significant and unexpected economic event;

- (b) An action that is part of the target company's ordinary course of business but that has triggered an overly restrictive condition of the offer;
 - (c) An action that would trigger a condition in the offer but that condition is not commercially critical to the offer, or the offeror would be unreasonably relying on or invoking the condition; or
 - (d) The action is taken in the context of an offer that has reached a position of having no reasonable likelihood of success.
25. Whether the Panel publishes a decision under rule 39(c) will depend upon the degree of public interest and relevant concerns of commercial confidentiality. A takeover offer is a public transaction and, accordingly, there is likely to be public interest in any decisions made by the Panel under rule 39(c).

Question 6:

Are there any objections to the Panel publishing its decisions under rule 39(c)?