DEFENSIVE TACTICS

Guidance Note

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TAKEOVERS PANEL
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1 Introduction

1.1 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.

1.2 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);

(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; and

(c) the meaning of "imminent" in rule 38(1) of the Code.

2 Meaning of defensive tactics

2.1 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,[1] 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.[2]

2.2 The Code does not describe the specific kinds of actions taken or permitted by a target company that are prohibited as defensive tactics. The following are examples of actions that could, depending on the circumstances, breach rule 38:

(a) acquiring or disposing of a major asset;

(b) incurring a material new liability or making a material change to an existing liability (this could include, for example, the variation of existing contracts to include clauses that would be triggered by a takeover);

(c) declaring an abnormally large or unusual dividend or other form of capital distribution;

(d) undertaking material issues of new shares or repurchases of existing shares, or material issues of convertible securities;

(e) entering an agreement with a third party that confers material economic benefits on the target company which are available only to one particular bidder;[3]

(f) acquiring an asset that would render the offer subject to regulatory approval (such as under the Overseas Investment Act 2005 (**OIA**) or the Commerce Act 1986) that was not anticipated by the offeror prior to the issuing of a takeover notice under rule 41 of the Code; or

[1] Refer to paragraphs 4.1 to 4.12 for comments on the meaning of "imminent".
[2] Takeovers Code, rule 38(1).
[3] Takeovers Panel *Section 32 Determination Tranz Rail Holdings Limited* (6 August 2003), paragraph 46.

(g) refusing to provide, or unreasonably delaying the provision of, information to an offeror that the offeror cannot otherwise reasonably obtain, which is required for the offeror to:

(i) assess whether it needs to apply for consent under the OIA; or

(ii) prepare an application for consent under the OIA.

2.3 This list is not exhaustive.

2.4 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.

2.5 Nothing prevents the directors of a target company from taking steps to encourage competing bona fide takeover offers from other persons.[4]

2.6 The Panel considers that it is not a defensive tactic if the directors of the target company, with good reason to do so, recommend that an offer be rejected.[5]

2.7 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.[6]

Restrictive conditions in offers

2.8 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.

2.9 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 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.

2.10 It is worth noting that rule 25(1A)(a) of the Code provides that an offeror may not allow an offer to lapse in reliance on a condition of the offer that restricts the target company's activities in the ordinary course of the target company's business during the period that begins with the sending of a takeover notice and ends on the date by which the offer must become unconditional.

Target company information

2.11 In general, rule 38 does not require (and cannot be used to require) target companies to provide information to an offeror, even if the offeror requests the information. For example, if an offeror requests due diligence-type information or confirmations from a target company, or includes conditions in its offer that require the target to provide such information or confirmations, the target will generally not breach rule 38 by refusing to provide that information or those confirmations.[7]

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[4] Takeovers Code, rule 38(2).

[5] 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.

[6] Takeovers Panel *Section 32 Determination Tranz Rail Holdings Limited*, paragraph 48.

[7] Takeovers Panel *Section 32 Determination Rubicon Limited* (19 May 2004).

2.12 Despite the general position set out above at paragraph 2.11, refusing to provide, or unreasonably delaying the provision of, information to an offeror that the offeror cannot otherwise reasonably obtain, which is required for the offeror to assess the need for, or obtain, consent to acquire a relevant interest in "sensitive land" under the OIA may be a prohibited defensive tactic.[8]

2.13 The Panel's general view is that, if a takeover notice has been received and if the overseas offeror makes a request, the target company must provide certain information about the target's interests in land to the offeror within a reasonable timeframe. Failure to do so may result in a breach of rule 38. Specifically:

(a) The information to be provided (the **Required Information**) should be sufficient to enable the offeror to assess whether OIA consent is required, and/or prepare an application for OIA consent. Typically, the Required Information will be limited to:

(i) a list of the target company's interests in land (including the relevant address) that cannot be readily obtained through registered title searches in the name of the target and its subsidiaries; and

(ii) for each interest, the nature and duration of the interest, as well as a description of the land use,

although it is possible that an offeror might require further information.

(b) What is a reasonable period of time to comply with the offeror's request may vary from case to case. In general though, once a target has received an offeror's request for Required Information, all of the Required Information should be provided as soon as practicable. In addition, the target should advise the offeror immediately after the request is made if it knows that it has an interest in sensitive land.

2.14 In some instances, some of the Required Information may be confidential. Where this is the case, the target may require the offeror to enter into a confidentiality agreement prior to providing the information.

2.15 It is possible that a target company would similarly be required to provide the offeror with information in relation to other statutory consents. However, in such instances, the Panel expects that the offeror will need to show at least that the statutory consent is required, that the information is required in order to obtain the statutory consent, and that the offeror has no other reasonable way to obtain the information. The Panel will consider issues relating to consent required under legislation other than the OIA on a case-by-case basis. The Panel expects that it is unlikely that information would need to be provided in relation to any clearance or authorisation under the Commerce Act 1986, as the information sought should largely be already available to the offeror, or may be obtained through the ordinary processes of the Commerce Commission.

3 Provisos

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

Proviso (a): Resolution of shareholders

3.2 Pursuant to rule 39(a) of the Code, 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. Rule 39(a) of the Code does not allow for retrospective shareholder approval of a defensive action. However, it would not prevent the target company's directors from entering into an agreement to take an action (which would otherwise be prohibited as a defensive tactic) that is

[8] Relevant interests include any legal or equitable interests, for a term of three years or more (including rights of renewal). For example, if a target company has an unregistered lease of sensitive land for a term of three years or more, consent is required.

conditional on obtaining the approval of the shareholders of the target company before any such action is taken.

3.3 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 under the Companies Act 1993 or the NZX Listing Rules.

3.4 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.

3.5 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.[9]

3.6 The Panel considers that it is not possible for a rule 40 resolution to retrospectively approve the actions of directors.[10] However, as noted above, an action that would be prohibited can be agreed by the directors if it is conditional on first obtaining a rule 39(a) approval resolution of shareholders.

Proviso (b): Pre-existing obligation or proposal

3.7 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]

3.8 This proviso is strict in its application. It does not extend to matters that are under consideration by the directors but on which they have, as yet, not made an approval decision.

Proviso (c): Panel approval

3.9 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.

3.10 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. The Panel is reluctant to "stand in the shoes" of shareholders if a decision would be more appropriately made by them.

3.11 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, alone are not sufficient reasons.

3.12 The Panel will consider all the circumstances of the particular case when it decides 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; and

[9] Takeovers Panel *Section 32 Determination Otago Power Limited* (31 May 2002), paragraph 46.
[10] Ibid, paragraph 46.
[11] Takeovers Code, rule 39(b).

(c) the effect that the action may have on the offer (or any potential offer).

3.13 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). If appropriate, the Panel would invite the target company to make submissions on whether the Panel's decision should be published.

4 Meaning of "imminent" in rule 38(1) of the Code

4.1 Rule 38(1) of the Code prevents the board of a target Code company from engaging in defensive action when it has received a takeover notice or has "*reason to believe that a bona fide offer is imminent*".

4.2 The question as to whether an offer is imminent can arise in many and varied circumstances - from significant acquisitions of the company's shares accompanied by market speculation of a takeover through to an approach by a party for information, or to undertake due diligence, supported by a highly conditional, non-binding, confidential agreement relating to a possible acquisition of the company.

4.3 In each of these examples, whilst there is no certainty that a takeover offer will follow, the directors have to make a judgement as to whether or not an offer is imminent. The decision is critical given that steps taken in the ordinary course of the business by the directors may be regarded as defensive tactics which breach rule 38 of the Code.[12] This Guidance Note is intended to assist directors of Code companies in making that judgement.

4.4 Rule 38(1) establishes two quite distinct thresholds, both of which would need to be met in order to establish a breach of the rule:

(a) whether a Code company has received a takeover notice, or has reason to believe that a bona fide offer is "*imminent*"; and, if so

(b) whether an action permitted or taken by the directors of the company, in relation to the company's affairs, could effectively result in an offer being frustrated or in shareholders being denied an opportunity to decide on the merits of an offer.[13]

What does "imminent" mean?

4.5 This section of the Guidance Note focuses on the definition of "*imminent*" under the first threshold in rule 38(1). The meaning of "imminent" is not defined in the Code. The fact scenario below sets out how the Panel has dealt in the past with a question regarding the imminence of a possible takeover offer.

Fact scenario

4.6 The Panel received a complaint from Company B (**B**) that Company A (**A**), a Code company, had taken defensive action in breach of rule 38 when a takeover was "*imminent*". B complained to the Panel about an announcement that had been made by A that A intended to sell a significant asset. In particular B alleged that the announcement amounted to a defensive action by the directors of A and that any disposal of that asset would not be permitted by rule 38 of the Takeovers Code.

4.7 B had made a market stand to acquire 19.99% of the voting rights in A. A had announced the proposed sale of its asset one week later, the directors of A having approved the proposed sale one day prior to making the announcement. B had not announced an intention to make a takeover offer at that time. Even at the date of the complaint to the Panel some four weeks later, B had not made any statement to the market or to A of an intention to make a takeover offer.

[12] See paragraphs 2.8 to 2.10 for more information about defensive tactics.
[13] See paragraphs 2.1 to 2.7 for more discussion of this issue.

4.8 The Panel also noted that the only evidence B had provided to support its complaint that A may have believed that it had an imminent takeover offer, was media speculation that an offer was imminent. However, in the media statements, B publicly stated that it had "*no imminent plan*" to make a takeover offer for the shares in A. Accordingly, B had not appeared to have announced to either A or to the market that it intended to make a takeover offer for A.

The Panel's consideration of "imminent"

4.9 In considering the matter, the Panel noted that the meaning of the word "*imminent*" in rule 38(1) could be interpreted in two ways:

(a) "*imminent*" could take its natural meaning of 'is very likely going to happen very soon', in a temporal sense. Such a black letter approach would suggest that a target company's assessment of whether a bona fide offer was imminent would be a reasonably high threshold; or,

(b) "*imminent*" could be interpreted from a policy standpoint having regard to the mischief rule 38 addresses - which is that shareholders should not miss the opportunity of considering an offer because the target company discourages an offer by an initiative it takes. This would lower the threshold at which the board of the target company should consider an offer was "*imminent*".

4.10 The Panel considered that implying too much policy into rule 38 would make the threshold of when a bona fide offer was "*imminent*" too low. A strict policy approach to rule 38 might be seen as protecting shareholders from the situation of being prevented from receiving an offer. In this case "*imminent*" would not have a temporal sense; it would apply where the board of the target takes a step motivated by the prospect of a takeover offer in order to make it more difficult.

The Panel's decision

4.11 The Panel decided not to take action because it appeared that B could not establish that A had "*reason to believe that a bona fide offer* [was] *imminent*" for the purposes of rule 38. The only evidence provided to the Panel by B was media speculation to that effect. The Panel decided that it was not appropriate to interpret "*imminent*" solely in a temporal sense. If B had conveyed to A that it intended to make a takeover offer, even if it would take some time to make the actual offer, the Panel considered that that advice may have been sufficient to reach the threshold of "*imminent*" within rule 38(1). Therefore, "*imminent*" is only temporal in one sense in rule 38.

4.12 In relation to the words "*has reason to believe*" that an offer is imminent in rule 38(1), the Panel took the view that the test is objective and the question must be examined from the point of view of a reasonable target company board with all of the information that A had at the time it took the action.

Principles the Panel will apply

4.13 In determining whether an offer is "*imminent*", the Panel will apply the following principles:

(a) the threshold for imminence is neither:

(i) as high as the dictionary, or natural, temporal meaning of "*imminent*" which means: *is very likely going to happen very soon*; nor

(ii) as low as a policy-rich non-temporal meaning which would equate to a mere prospect of a takeover offer;

(b) the Panel will consider the particular facts of the case;

(c) the Panel will consider the policy behind rule 38 which may affect the Panel's view on whether the target company should have believed that an offer was imminent;

(d) the Panel's view under 4.13(a)(ii) may be influenced by the actions of the target company and the actions of the prospective offeror;

(e) the Panel will consider whether the prospective offeror has conveyed to the target company board that it intends to make an offer;[14] and

(f) the Panel will apply an objective test to the question as to whether a company "*has reason to believe*" that an offer is imminent.

[14] Prospective offerors should take care not to mislead Code company directors about a transaction or event that is likely to be regulated by the Code. Rule 64 of the Code (which prohibits misleading or deceptive conduct) has a very broad application.