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DAVID J. QUIGG

DEFENCES AGAINST TAKEOVERS

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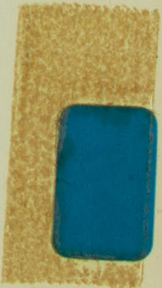

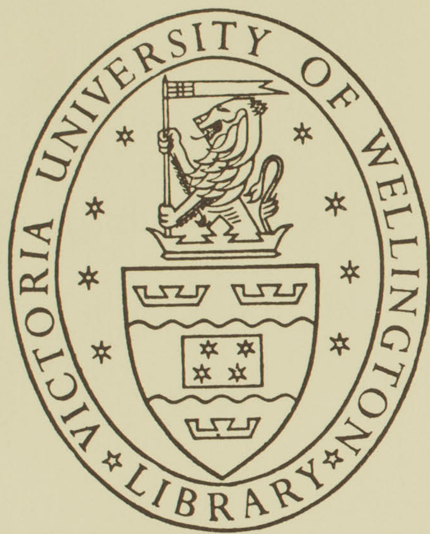

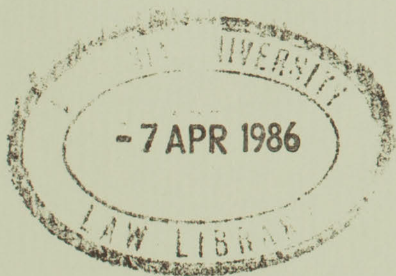

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DEFENCES AGAINST TAKEOVERS

		PAGE
1.00	INTRODUCTION	1
2.00	BACKGROUND TO TAKEOVERS	
2.10	General	1
2.20	Economic and Social Arguments - Takeovers - Benefit or Burden?	2
2.30	General Legal Framework for Takeovers	
2.31	The Companies Act 1955	3
2.32	The Commerce Act 1975	5
2.33	The Securities Act 1978	6
2.34	The Overseas Investment Act 1973	7
2.35	N.Z. Stock Exchange Listing Manual	8
2.36	The Common Law	11
3.00	DEFENSIVE STRATEGIES BEFORE A TAKEOVER BID IS IMMINENT	
3.01	Recognition that "YOU" are a possible target	12
3.10	Anticipatory Strategies/Be Prepared	
3.11	Watch on Share Registry	13
3.12	Signals from Share Registry	15
3.13	Shareholders - The Key to a Defence/Surveillance of Type of Shareholders	16
3.14	Market Rumours	20
3.15	Abortive Merger Talks/Announce Talks	20
3.16	Select Top Advisors	21
3.17	Up-to-Date Information Maintained	23
3.18	Proxies	24
3.19	Powers of Attorney/Decisions in Defence/Information on Raiders	24
3.20	Increase the Share Price /Information to the Market	25
3.30	Articles of Association	
3.31	Shark Repellants	29
	(i) Classified Board of Directors	30
	(ii) Supermajority Provisions	32
	(iii)Contingent Supermajority : Fair-Price Provisions	33
	(iv) Nominating Directors Procedure	35
	(v) Overseas Ownership Restricted	36
3.32	Disclosure of Beneficial Interest of Shareholding	37
3.40	Employment Contracts (two further shark repellants)	37
3.41	Golden Parachutes or Silver Wheelchairs	38
3.42	General Service Contracts	38
3.50	Voting Agreements between Shareholders	41
3.60	Interlocking Shareholdings between the Target Company and another Company or Companies ("Wheels")	45
3.70	Issue of Shares to "Friendly" party	51
3.71	Employees	51
3.72	Employee Superannuation Funds	52
3.73	Close Business Associate	53
3.74	Vendor	53
3.75	Overseas Shareholders	54
3.80	Defensive Merger ("White Knight")	54

3.90 Capital Reconstruction ("Poison Pills") 60
3.91 Non-Voting, Restricted or Weighted Voting Rights 60
3.92 Issue of Convertible Securities 63
3.93 Options for Shares 65
3.94 Split the Shares 71

3.100 Raise the Dividend 73

3.110 Bonus Issue Made 74

3.120 Management Buy-Out 75

3.130 Sell Assets/Loading Debts/Buy Assets ("Scorched Earth" or "Crown Jewel") 77

4.00 DEFENSIVE STRATEGIES AFTER A TAKEOVER BID IS MADE

4.01 Urging Shareholders Not to Accept the Offer/Issue "Don't Sell" Notice/Directors Recommendation 79

4.02 Criticise the Offer 81

4.03 Criticise the Raider/Ascertain the Raider's Objective 83

4.04 Disclose of New Information 84

4.05 Bid for Raider ("Pac-Man") 89

4.06 Share Dealing
(a) Purchase target company's shares by its Directors or third parties 90
(b) Purchase/sell raider's shares by the target company or its Directors 92

4.07 Appeal to The Courts 93

4.08 Intervention by The Commerce Commission 96

4.09 Intervention by the Securities Commission 99

4.10 Threaten Management Resignation (the "Neutron Bomb" defence) 101

4.11 Urging the Raider's Shareholders to Oppose their Board's Takeover Bid for the Target Company 101

4.12 "Standstill" Agreements 102

4.13 Use Business, Social and Political Relationships 104

5.00 CONCLUSION 107

BIBLIOGRAPHY

LIST OF CASES

ACKNOWLEDGEMENTS

DEFENCES AGAINST TAKEOVERS

1.00 INTRODUCTION

This paper will deal with the practical steps available to a company ("the target company") in order to make that company less likely to incur a significant change of ownership [1] instigated by another person or company ("the raider") without the Directors of the target company being consulted and in agreement with such change of ownership.

2.00 BACKGROUND TO TAKEOVERS

2.10 General[2]:

Takeover activity is seen as one of the many variables affecting the general performance of the share market for publicly listed companies.

(1) This can be less than a 50% shareholding of a company.

(2) The Commerce Commission received 279 merger or takeover proposals in the first year of operation of the Commerce Amendment Act 1983 - The Evening Post 24 April 1985. These figures exclude takeovers not within the terms of the Commerce Act 1975 (as amended).

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2.20 Economic and Social Arguments - Takeovers - Benefit or Burden?

Whether takeovers are a benefit or a burden to the community and the companies involved is presently a topical issue.(3)

Takeovers can be perceived from many different perspectives, such as:

(i) The Community at large. It may be believed that takeovers assist in the rationalisation of unproductive industry and increase efficiency and growth in the corporate sector. Alternatively, takeovers can be seen as wasting resources that could be better spent elsewhere thus affecting the community at large not merely the companies involved (eg employment etc).

(ii) The Companies involved. The shareholders of the target companies if their shares are purchased by a raider, almost always profit and the threat of takeovers keep the existing management of a target company on their mettle. However, some people may believe that the defences implemented are more likely to be in the interests of the existing management of the target company rather than the company itself and both raider and target company may be worse off after the takeover battle, regardless of whether the takeover is successful.

(3) See: J. Greenwald "The Great Takeover Debate" TIME 22 April 1985 page 30; The Evening Post 29 January 1985 page 8 an article headed "Treasury Flaws Takeover Reform"; The Evening Post 17 October 1984 page 24 an article headed "Takeover Companies Fare No Better; M. Firth "Takeovers : Benefit or Burden" (1981)62 The Industrial Analyst page 29; J. Greenwald "Bigger Yes, But Better?" TIME 12 August 1985 page 32; The Dominion 12 August 1985 page 13 an article by T. Hall headed "Too many on the takeover trail"; and Peter Dodd "The Financial Economics View of Regulation of Mergers and Takeovers" and C.I. Patterson "Company Takeovers - Proposals For Reform" both papers presented at the Seminar on Mergers and Takeovers, Victoria University of Wellington organised by the Department of Accountancy, 29th August 1985.

2.30 General Legal Framework for Takeovers:

There is no comprehensive legislative scheme regulating takeovers in New Zealand.[4]

Existing New Zealand Takeover Law:

2.31 The Companies Act 1955 and the Companies Amendment Act 1963.[5]

(4) Hogg C.G.G. "A Takeover Law for New Zealand - an American Perspective" (1985)15 Victoria University Law Review (V.U.L.R.) 101,102. See also an article "Takeover Laws are Outdated" (1983) the New Zealand Financial Review September p.68 (unauthored), and P.E. Ratner "Company Takeovers" (1984) NZLJ 5, and T.R. Hurst "Self Regulation versus Regulation" (1984)5 The Company Lawyer 4 No. 4 page 161 (UK).

(5) One must not forget the rights of the minority shareholders in a takeover situation - see H. Bond "The Statutory Protection of Minority Shareholders" (1984) 5 The Company Lawyer No. 4 page 155 (UK).

This legislation governs the procedures for making a takeover offer(6) (as defined in that Act) and covers certain other matters relevant to takeovers, principally the following:(7)

(a) Provisions dealing with payments to company directors (ss. 191-194).

(b) Provisions prohibiting a company from financing the purchase or assisting in the purchase of its own shares (ss. 62).

(c) Provisions enabling the compulsory acquisition of the outstanding remainder of shares after a takeover (s.208).

(d) Provisions for the amalgamation and reconstruction of companies (ss. 205-207).

However this legislation in practice has very limited application(8) because of class of transactions exempted (9) and because it only applies to written takeover offers.(10)

(6) See the Securities Commission Report "Discussion and Proposals for Reform - Company Takeovers" - A Review of the Law and Practice Volume 1 dated 5 October 1983 ("the Securities Commission Report") paragraphs 3.2 to 3.15.

(7) Hogg C.G.G. supra n.4. page 104 - The Securities Commission Report supra n.6 para 3.16.

(8) Hogg C.G.G. supra page 103 and the Securities Commission Report para 3.4.

(9) The exempted transactions are:
(i) the acquisition of shares in a private company where all the offerees have waived the requirements of the 1963 Amendment; and
(ii) an offer as part of a "takeover scheme" to six or fewer shareholders.

(10) The concept of written offer has been narrowly defined by the Courts -See Multiplex v. Spear [1966] NZLR 122,150; Carter Holt Holdings Limited v. Fletcher Holdings Limited [1980] NZLR 80,86, and Tatra Industries Limited v. Scott Group Limited (1983) NZCLC 95,079.

2.32 The Commerce Act 1975 (Part III)[11]

The main purpose of the Commerce Act is to regulate the markets for, and dealings in, goods and services other than securities, and impacts upon securities law for the better attainment of that main purpose.[12]

Part III establishes a takeover review procedure which is confined to monopoly and competition (antitrust) considerations.[13]

(11) None of the following structural details will be significantly changed by the Commerce Bill 1985 (No. 104-1) other than the asset threshold levels as described below.

(12) The Securities Commission Report n.6 para 3.1(b). See also the papers by John Collinge, Chairman of the Commerce Commission, "Merger and Takeover Policy and Procedures in New Zealand" and M. Hill "The Evolution of New Zealand Merger Control and its Administration By the Office of the Examiner of Commercial Practices" presented to a seminar on Mergers and Takeovers in 1984 at the University of Canterbury, and the paper by J. Collinge "Towards A Competition Policy in New Zealand" at the seminar on Mergers and Takeovers in 1985 at the Victoria University of Wellington.

(13) Hogg C.G.G.supra n.4 page 104.

Generally speaking the Commerce Act review procedure applies to "takeover proposals" for the acquisition of 20 per cent or more of the target's shareholding. The Commerce Act does not generally apply to takeovers involving smaller companies because asset threshold levels for the participants in the takeover must be met before such takeover requires prior clearance or authorisation by the Commerce Commission. (14)

The necessary consent, if required, by the raider in a takeover situation is normally obtained prior to the attack on the target company or the offer made by the raider is stated to be subject to such consent being obtained. The Commerce Commission does not require mandatory disclosure of a bid by a raider to either the target company or its shareholders when applying for Commerce Commission consent.

2.33 The Securities Act 1978:

The Securities Act established the Securities Commission and the regulation of the terms under which "securities" may be advertised and offered to the public.

The definition of "securities" is very wide (15) and would include shares.

(14) Presently in the case of a merger and takeover proposal involving not more than 2 participants, the value of the assets of the smaller participant must be at least $2,500,000 and the aggregate value of the assets of all the participants must be at least $20,000,000 before the Commerce Act 1975 provisions apply (under the Commerce Bill 1985 those figures would be increased to $5,000,000 and $50,000,000 respectively). See also J. Collinge "Merger and Takeover Procedures under the Commerce Act" (1985) NZLJ 260.

(15) See Sections 2 and 5 of the Securities Act 1978 and Chapter 4 of Darvell and Clarke Securities Law in New Zealand Butterworths 1983.

The Securities Act provisions may be relevant if a takeover offer was made by "standing in the market" (15A), and instead of offering cash, offered shares of the raider or a third party. It may be argued in such circumstances that a prospectus is required to be issued (15B).

The Securities Commission may also investigate a takeover or defensive strategies employed under its general jurisdiction. (15C)

2.34 The Overseas Investment Act 1973

The Overseas Investment Act 1973 and Regulations under that Act set out procedures for the implementation of national policies relating to overseas investment in New Zealand companies by persons who reside overseas.

(15A) A takeover offer within the meaning of Part I of the Companies Amendment Act 1963 (i.e. in writing) is deemed not to be an offer of securities to the public - Section 3(2)(c) of the Securities Act 1978.

(15B) This type of argument has been raised successfully in Australia see Broken Hill Proprietary Co. Ltd v. Bell Resources Ltd [1984]8ACLR 609. See also G.J. Samuel "Takeovers and Public Securities" (1984)2 Company and Securities Law Journal No. 2 page 124 (Aust), N. O'Bryan "Takeover Offers and Prospectus Requirements" (1985)3 Company and Securities Law Journal No. 1 page 3, and the case Australian Central Credit Union v. Corporate Affairs Commission (SA) [1985] 9 ACLR 718 (This case is under appeal -Companies and Securities Bulletin June 1985 14 [Aust]).

(15C) City Realties Limited v. Securities Commission [1982]1 NZLR 74 (CA). See also C. Cripps "Company Takeovers - Too Many Tribunals Not Enough Remedies" (1982) NZLJ 395.

2.35 N.Z. Stock Exchange Listing Manual ("The Stock Exchange Code"): The manual sets out in Section 6 of the Takeover Code for companies listed on the New Zealand Stock Exchange.

Section 6 covers the following matters [16]:

(a) Disclosure of the terms of a bid should be made to the target Board of Directors and shareholders of the target company. [17].

(b) A general restriction on insider trading [18].

(c) A general restriction of defensive tactics that may be undertaken by the Board of Directors of the target company, stated as follows:

"The offeree [target] Board is not to take action to thwart an offer unless it honestly believes that acceptance is not in the best interests of shareholders..."[19]

(d) Details of proration for partial bids and increases in offering price. [20]

(16) See Hogg C.G.G. supra n.4 pages 104-105. These will not be significantly altered by recent proposed changes presently being discussed - letter from the New Zealand Stock Exchange - 29.5.85.

(17) Paragraph 607 of the Stock Exchange Code.

(18) Paragraph 602 and 603 of the Stock Exchange Code. See also C.I. Patterson "Insider trading and business ethics" (1984) NZLJ 369.

(19) Paragraph 609 of the Stock Exchange Code.

(20) Paragraph 613 of the Stock Exchange Code. See N.Z. Forest Products Limited v. New Zealand Stock Exchange (1984)2 NZCLC 99,051 (High Court) & [1984]1 NZLR 699 (Court of Appeal).

The language of Section 6 is general and precatory rather than specific and mandatory[21]. The Code operates only as a contract among listed companies and brokers.[22] Sanction for breaching the Code is limited to the delisting of a Company's securities[23] or disciplining a broker.[23A]

(21) Hogg C.G.G. supra n.4 Page 105.

(22) Hogg C.G.G. supra n.4 Page 105. See Stock Exchange Association of New Zealand v. Commerce Commission [1980] 1 NZLR 663 and N.Z. Forest Products Limited v. New Zealand Stock Exchange supra n.20.

(23) Examples: N.Z. Forest Products Limited in 1984 concerning takeover triangle of NZFP, Goodmans and Watties. Waitaki NZR when BIL was seeking a 15% shareholding and Waitaki NZR issued an option for shares to a third party.

(23A) Paragraph 108 of the Stock Exchange Code and the Listing Agreement.

One commentator has noted that delisting may hurt most those whom the Code seeks to protect - shareholders of the target company (24). In addition that commentator noted that the Code is powerless against a raider being a private company. (25)

Delisting may in fact be sought by a target company so that it is more difficult to trade the target company's shares. Richard Carter, Managing Director of Carter Holt Limited is reported as saying:

> "Do anything to delay [a takeover bid]. Do something that's strong enough to get delisted. Go that far without hesitation. If you're delisted they can't trade shares. Do anything, worry about the court cases afterwards. Do it in such a way that you can wind it back whenever you want to, ..." (25A)

(24) Hogg C.G.G. supra Page 105. The commentator also referred to the case of Norlin Corp. v. Rooney, Pace Inc. [1984] Fed. Sec. L.Rep (CCH) 94, 564 (2nd Cir, 27th June 1984) where the Second Circuit Court of Appeals regarded delisting as ipso facto causing injury to shareholders.

Another commentator believed the power of delisting relatively impotent -see Forbes C.W. - "Defensive Tactics in the Face of an Unwanted Takeover Offer" University of Auckland 1980 (a paper in partial fulfilment of an LLM).

(25) Hogg C.G.G. supra n.4. Page 105.

(25A) The New Zealand Times 7.7.85

2.36 The Common Law

The Common Law (eg conspiracy, fraud, misrepresentation) may be relevant, however it is unusual if it arises in takeovers.(26)

The fiduciary duty on Directors of the target company is important.(26A) The Directors must act in the best interests of the company as a whole(26B) rather than motivated by the desire to protect their own position.(27)

As the Common Law is alway being reinterpreted the Directors of the target company should retain legal advisors who can give counsel as to a Director's fiduciary duty when contemplating implementing strategies as defences to takeovers.

(26) Hogg C.G.G. supra n.6 page 103. See however Trounce and Another v. N.C.F. Kaiapoi Limited (High Court Christchurch 11 June 1985 [A183/85] Heron J.) and Baigent v. D.McL. Wallace (1984)2 NZCLC 99,122.

(26A) D. Gonski and P. Keenan "Legal Protection and Vulnerabilities for the Corporation" (pages 2-6) presented at a conference on Defence Against Takeovers : The Corporate Response held in Sydney 17.9.85 (Australia).

(26B) For the benefit of current and future shareholders, employees and creditors (as to creditors see Nicholson & Ors v. Permakraft (NZ)(In Liq) (1985)3 ACLR 453 D. Gonski and P. Keenan supra n.26A page 2.

(27) Hogg v. Cramphorn Limited [1967]Ch. 254, Howard Smith Ltd v. Ampol Petroleum Ltd [1974]A.C. 821 (PC) and Cayne v. Global Natural Resources Plc (Chancery Division, 12 August, 1982 unreported, but see (1982)56 ALJ 600 and D. Gonski and P. Kennan supra n.26A page 3. See also Weinberg and Blank on Takeovers and Mergers (2 ed., Sweet and Maxwell London 1979) paragraph 2401, Y. Danziger and K. Skoyles "The Right of Target Companies to use Corporate Funds in Defence of Takeover" (1985)5 The Company Lawyer No. 5 page 217 (UK) and papers by R. Halstead "Directors' Duties and Long Term Defence Strategies" and P. Mason "Directors' Duties and Long Term Defence Strategies to deter Attackers" (pages 1-3) presented at a seminar on Takeovers Mergers and Acquisitions held in Sydney 12.7.85 (Australia) see also paragraph 609 of the Stock Exchange Code.

3.00 DEFENSIVE STRATEGIES BEFORE A TAKEOVER BID IS IMMINENT

3.01 Recognition that "YOU" Are A Possible Target:

Before any defence strategies are useful there must be the recognition by the target company that "IT" is a possible target and that it believes defensive strategies are appropriate. [(27A)]

Defensive strategies should be implemented before a takeover bid is imminent if they are to be the most effective.

No company, big or small, is free from a possible takeover. [(27B)] However, effective prevention is best achieved by individuals holding, directly or indirectly, more than 50 per cent of their companies. [(27C)]

(27A) See for background R.T. Lang, D.J. Block, N.E. Barton and G.K. Duberstein "The Dramatization of a Hostile Tender Offer" American Bar Journal (1984) Volume 70 March pages 68-73 and April 72-77.

(27B) Sir Ronald Trotter - Chairman Fletcher Challenge Limited has been reported as saying:

> "... any company can be vulnerable to takeover unless it performed well, had good profits and kept shareholders fully informed". The Dominion 5.7.85.

(27C) P. Mason supra n.27 (pages 3-4)
S. Higgs, W. Chant and R. Halstead "Takeover Defence : The Management Response" a paper presented to a conference on Defence Against Takeovers : The Corporate Response held in Sydney 18.9.85 (page 3).

To ascertain whether "YOU" are a target for a takeover continuous monitoring of the following is required:

(a) shares owned by management
(b) analysis of how shares are held - type of shareholder
(c) shareholder disenchantment
(d) undervalued or suplus assets
(e) unattractive balance sheet
(f) undergearing
(g) underperforming businesses
(h) current market price v. future prospects
(i) other acquisitions in the industry.(27D)

3.10 Anticipatory Strategies/Be Prepared:

3.11 Watch on Share Registry:
A close watch should be kept on the register of shareholders and movements in the shares should be noted with a view to ascertaining whether either there is an unusual turnover and/or whether a large number of shares appear to be accumulating in the hands of one person or company.(28) It may not be easy to identify the person of company if use is made by the raider of nominees.

(27D) Memorandum headed "Issues Relating to Responses to Unsolicited Offers [Under Delaware Law], by Sullivan and Cromwell, a New York law firm, dated April 23 1985, pages 26-27 ("Sullivan and Cromwell"). R.A. Ross "Profile of the Target Company : the Defence before the Defence" a paper presented to a Conference on Defence Against Takeovers : The Corporate Response held in Sydney 17.9.85 (page 2).

(28) S. Lofthouse "Strategy and Tactics for Resisting Takeover" (1984) Long Range Planning (UK) Volume 17 No. 4 page 38, 43. L. Goodman "Contingency Planning for a Takeover Bid" (1981) Finance Director's Review (UK) Vol. 1 No. 24 page 185.

The Stock Exchange Code provisions allowing a company to ascertain the beneficial owner of shares in certain circumstances (29) are not likely to be of assistance (30) as the raider may not be a New Zealand listed public company, the raider may be a private company not caught by the Code provisions (31) or the target company may not have brought its Articles of Association line with the powers allowed by the Code.

(29) Paragraph 453(2)(3) of the Stock Exchange Code. The Code allows a company to provide in its Articles that a statutory declaration specifying the beneficial owner of shares may be required by the Directors of the Company in certain circumstances relating to the transfer of shares (for example if the transfer relates to shares comprising 0.5% or more of the company's issued shares of their class or the registration of the transfer would result in the transferee holding 1% or more of the company's issued shares of their case.)

(30) See the example of the mystery buyer of AHI shares a couple of days prior to the Carter Holt bid for AHI. The Securities Commission investigated this matter seemingly to ascertain whether there had been any "insider trading". The Securities Commission are reported as knowing who the buyer was however the Chairman is reported as saying:
"Under the law as it stands, the buyer is not required to reveal his identity" - The Dominion 3/5/85, an Article by T. Withers headed "Mystery AHI buyer uncovered". See also discussion of the recent mystery bidder for part of the capital of CPD the Article by J. Clifton headed "CPD chairman hits 'masked men'" The Dominion 28/8/85 (page 17).

(31) It may be useful to ensure that there is an Article in the company's Articles of Association, which disenfranchises any nominee who fails to disclose the beneficial ownership of the shares. L. Goodman supra n.28 page 186. See paragraph 3.32 of this paper.

A list of nominee companies and their beneficial owners and a list of firms of brokers/solicitors noting their major clients should be maintained. If the takeover vehicle is a "shell" private company then it is likely that the raider's brokers/solicitors provided such a "shell" company. Searching the "shell" company should provide the information of which firm of solicitors acts for or formed the company. Therefore, knowing the firm's major clients may allow the target company to make an educated guess as to the person or company behind the "shell" company. A list of major clients of sharebrokers should also be obtained so that the target company can make another educated guess who each broker is likely to be acting for if purchasing significant shares in the target company.(32)

3.12 Signals from Share Registry:

Signals that a person or company is acquiring a significant shareholding in the target company include:

(a) An accumulation of shares in one or more nominee names;

(b) a broker persistently buying in the market;

(c) underlying strong tone to the share price and possibly relative outperformance of the share price;

(d) unusually large number of transactions in the shares of the target; and

(e) a request for a list of shareholders(33).

The target company should remember that a raider may defer registering share transfers.(33A)

(32) Note however the case of the takeover of Allied Mills in Australia where Apex Limited used the same broker as that used by Industrial Equity Limited ("I.E.L.") as it was "hoped by using the same broker as IEL [Apex] might throw some confusion into the market" - The Dominion 4th June 1985.

(33) S. Lofthouse, supra n.28 page 43. A. Vrisakis and G. Samuel "The Defence Strategy" a paper presented to a conference on Defence Against Takeovers : The Corporate Response held in Sydney 18.9.85 (page 4).

(33A) A. Vrisakis and G. Samuel ibid comment received on the paper.

It is advisable that systems be established with the target's brokers and registrar to provide the necessary information on the signals to be watched quickly.(34)

3.13 Shareholders - The Key to a Defence/Surveillance of Type of Shareholders:

The key to a successful takeover defence is to motivate shareholders not to accept a takeover offer.(34A) If the shareholders of the target company believe the Board of Directors are achieving the shareholder's goals (eg financial, secure employment) then any offer will be rejected.(34B) The shareholders must have confidence in the Board of Directors of the target company and a "good track record" gives the Board of Directors credibility.(34C)

It is also very useful for the target company to maintain surveillance of the type of shareholders present at any one time. (35) The type of shareholders being:

(i) Private individual shareholders.
(ii) Institutional shareholders being:
  (a) pension/superannuation managers and their companies.
  (b) insurance company managers and fund managers.
(iii) Other companies being:
  (a) investment companies
  (b) other companies.

(34) L. Goodman supra n.28 page 186.

(34A) P. Mason "The Key to a Defence Strategy" a paper presented to a conference on Defence Against Takeovers : The Corporate Response held in Sydney 17.9.85 (page 1).

(34B) P. Mason ibid page 2.

(34C) P. Mason ibid page 2.

(35) L. Goodman supra n.28 page 186.

It seems some shareholders are sometimes less likely to sell their shares if approached by a raider which has not got the target Board's approval. Previously private individual shareholders, not dealers in the market, seem to have consistently shown intense loyalty to the Board of Directors of Companies in which they are investors[36] however "shareholder loyalty" should not be assumed in today's economic climate.[36A] Also insurance company fund managers tend to take a longer term view of their shareholdings compared to superannuation fund managers who are under pressure to demonstrate the superior performance of their funds in the short term as compared with the other funds.[37]

(36) L. Goodman supra n.28 page 186.

(36A) Discussion on the paper presented by P. Mason supra n.34A.

(37) L. Goodman supra n.28 page 186.

Although a Board of Directors cannot choose its shareholders it can encourage certain potential buyers of shares while, of course, taking the usual care not to alienate other existing or potential shareholders.[38] The Board could do one or more of the following[39]:

(i) On a rights issue placing or other equity issue, an underwriting list or list of places might be prepared with an order of preference.

(ii) The target Company's brokers may be requested that in the normal course of business they might offer shares in the target company which come on the market to certain preferred institutions before others.

(iii) Particular institutions may be encouraged to take an interest in the target company through meetings with senior management or visits to the operation.[40]

(38) L. Goodman supra n.28 page 186.
S. Lofthouse supra n.28 page 42.

(39) L. Goodman supra n.28 page 186.

(40) See an article appearing in The Dominion 5/7/85 which noted that Fletcher Challenge Limited ("FCL") management was to make a trip to the UK seemingly in an effort to increase its shareholding by UK Investors. Also recently BHP senior management has been visiting the USA to speak to possible investing institutions (The Dominion May 1985). Overseas shareholding may potentially be risky if the target company's currency devalues as against the currency of the overseas shareholding. This has happened in 1984/85 with the Australian $ and the United States $. BHP's U.S. shareholders may now be keen to dispose of their shares. (See The Business Review Weekly June 7 1985 page 14-19).

(iv) The target company may encourage private shareholdings by offering some form of perk to shareholders. (41)

(v) The target company may encourage employee shareholders who naturally place importance on security of employment. (41A)

(vi) Customers or suppliers may be offered shares and they would seek ancilliary benefits (eg rebates and discounts). (41B)

(vii) Seek to obtain favourable press comment for the target company. This can be influential in attracting private individual shareholders.

(41) Perks include: bonus issues, rights issues at a deep discount, dividend reinvestment schemes, returns of capital, spin-offs and rights to new issues of shares of associate companies (P. Mason supra n.27 page 4 and R.A. Ross supra n.27D page 14). Smaller shareholders like bonus issues (P. Mason supra n.34A page 1). It seems experience suggests that the market responds more positively to an issue with a small bonus element coupled with a separate bonus issue than to an equivalent larger bonus element in the rights issue (R.A. Ross supra n.27D page 14).

For example recently Queenstown Resorts Limited which gave shareholders discount cards for use at its hotel establishments (New Zealand Times 23 June 1985 page 15).

(41A) P. Mason supra n.34A page 1.

(41B) P. Mason ibid.

3.14 Market Rumours:

A target company should monitor market rumours and request that their broker immediately pass on rumours concerning the company.(42) A broker may note unusual market activity which would not be apparent to an outsider, which the broker should be requested to report as soon as possible.(43) Surveillance of newspapers and market journals should also be maintained by the target company.

3.15 Abortive Merger Talks/Announce Talks:

A target company may have been approached by another company concerning "exploring areas of mutual interest" and, if rebuffed as to a merger, other company may go directly to the target company's shareholders.(44) The target company, once approached, may issue a press statement stating that an informal approach has been made and the results of the discussions. This is only worth doing if there is an indication that an opposed takeover bid will be made, if necessary, by the other party. The press statement will probably increase the target company's share price and give the target company the initiative. Major shareholders can be approached before the raider has a case presented and a bid price established.(45)

(42) S. Lofthouse supra n.28 page 44.

(43) S. Lofthouse supra n.28 page 44.

(44) S. Lofthouse supra n.28 pages 43-44.

(45) S. Lofthouse supra n.28 page 43. See paragraph 509 of the Stock Exchange Code which sets out certain obligations on a listed company to notify the Stock Exchange when officers of the Company become aware of a firm offer for a significant part of the Company's issued capital.

3.16 Select Top Advisors:

A target company should ensure their broker, commercial banker, merchant banker, auditors, solicitors and public relations consultants are skilled in the takeover field.[46] This may involve a change from the target company's usual advisor in a particular profession. Regular liaison between advisors and the target company should be maintained.

Takeovers are now commonly carried out with full press coverage. Bad press coverage, even if the takeover bid is unsuccessful, could cause harm to the company's public image and/or its share price. This could make the target company even more vulnerable to another raider.

Overseas, and the writer believes increasingly in New Zealand, the target company's merchant bank carries the brunt of responsibility in a defence to a takeover. The target company therefore should have developed a good understanding with its merchant bank. This applies to a somewhat lesser extent to the target company's broker.[47]

(46) S. Lofthouse supra n.28 page 43.
"[ITT Corporation] has been readying its defences against marauders ... shortly after it cut its dividend by two-thirds. ITT has neither instituted staggered terms for its board members [see paragraph 3.3(i) of this paper] or handed out golden parachutes [see paragraph 3.41 of this paper] ... but ... [it] has lined up top legal, investment banking, and public relations help to plot defensive measures ... "Business Week 17th December 1984 page 66.

(47) L. Goodman supra n.28 page 186.

A target company may also wish to obtain a line of credit from its merchant bank or trading bank which could be called upon in the event of a takeover bid. Such funds may be needed if the target is to utilise the various defence strategies mentioned later in this paper.(47A)

The management of a target company should also take steps to develop their professional relationship with particular shareholders (especially institutions), involving meetings and/or visits given by senior management of the target company with those particular shareholders. The target company's public relations consultant should be utilised in order that these meetings and/or visits are carried out professionally and show the target company in the best possible light. (48)

It is preferable that the target company's advisors assess its vulnerability to a takeover offer at the earliest possible stage(48A) and set in motion a number of strategies to be persued by the target company.(48B) It can be critical, when under pressure from a raider, that the advisors know the target company, its philosophy, style and key management.(48C)

(47A) See paragraph 3.100 (Raise the Dividend), 3.130 (Buy Assets, and 4.05 (Bid for raider).

(48) L. Goodman supra n.28 page 186. S. Lofthouse supra n.28 page 41.

(48A) L.A. Bytheway "The Advisors : The Corporate Perspective" a paper presented to a conference on Defence Against Takeovers : The Corporate Response held in Sydney 17.9.85 (page 2). This is important for takeover defence strategies and also because it is better that defence strategies be employed prior to a takeover bid when considering the fudiciary duties of the Directors of the target company.

(48B) L.A. Bytheway supra n.48A page 2.

(48C) L.A. Bytheway supra n.48A page 2.

3.17 Up-to-Date Information Maintained:

A target company must be able to produce management accounting and financial information at short notice. Forecasts of profit and cash flow details may be required at short notice (possibly to be vetted by financial advisors).(49)

If the target owns substantial assets it may be wise to obtain, and keep up to date, independent valuations. Such information may be used to support the target's share price or justify a higher share price.

It is also useful for a target company to have (i) a regularly updated pro-forma announcement for release to shareholders of the target company if a takeover bid eventuates capable of being fine-tuned, printed and despatched quickly and (ii) a documented history of the target company's financial performance, including earnings and dividends per share and bonus and rights issues which it is hoped illustrate the target company's share value growth.(49A)

(49) L. Goodman supra n.28 page 186, Weinberg and Blank n.27 paragraph 1370, L.A. Bytheway supra n.48A page 5, and see also R. Grant "Company Valuations as a Basis for Defence Strategies" a paper presented to a conference on Defence Against Takeovers : The Corporate Response Sydney 18.9.85.

(49A) L.A. Bytheway supra n.48A page 5.

3.18 Proxies:

The target should also form a proxy list in order that, as far as possible, senior management and the Directors of the target know which major shareholders normally give their proxies to the company's directors. Agreement "in principle" could be tentatively arranged for proxies for defensive strategies contemplated by the target. A takeover attempt by solicitation of proxies for shareholders votes ("proxy contests") may possibly eventuate in New Zealand in the near future.(51)

3.19 Powers of Attorney/Decisions in Defence/Information on Raiders:

Powers of Attorney should be obtained from Directors of the target company to be held in case the takeover bid occurs while one or more directors are absent. (52)

(51) C.G.G. Hogg supra n.4 page 116:

> "It is not improbable that New Zealand will soon experience this method of seeking to gain corporate control by soliciting voters, given that the cash expenditure in seeking control by soliciting proxies is likely to be much less than in a tender offer [on market takeover]".

In the United States both the raider and the target company normally employ proxy solicitors.

(52) Weinberg and Blank supra n.27 page 575 footnote 4.

Also key senior management should be clear who does what and when if a bid does eventuate [53] in order that the target's response is not confused, such key senior management must remain up-to-date with the target company's takeover policy. Obviously, as confidentiality is critical, the number of key management involved in the target company's takeover policy should be limited in size.[53A]

It is important that a committee of the Board of the Directors of the target company or key management is appointed with sufficient delegated authority to make decisions without constant need to refer back to the full Board of Directors, except on fundamental policy matters.[53B]

Information on envisaged raiders should be compiled.[54] This information should be financial (eg especially if a competitor), legal (eg what defences have they in their Articles of Association), and other relevant information (eg shareholding - vulnerable to a counter takeover bid?).

3.20 Increase the Share Price/Information to the Market

"Managements use various methods and schemes to protect themselves from a possible takeover. However, there is an absolute way to avoid a takeover : Bring the company's market price as close to appraised value as possible, and then maintain it. That eliminates any problems with outside threats." [55]

(53) S. Lofthouse supra n.28 page 43.
Sullivan and Cromwell supra n.27D page 27.

(53A) Sullivan and Cromwell supra n.27D page 27.

(53B) Sullivan and Cromwell supra n.27D page 27.

(54) L. Goodman supra n.28 page 187.

(55) T. Boone Pickens, Jr. (President of Mesa Petroleum Co. a leading US takeover raider). Letter to the writer dated 10 May 1985.

This sentiment is echoed by Ivan Boesky a U.S. leading arbitrageur (The Evening Post 22/6/85) and R.A. Ross supra n.27D page 15.

If the target company can improve its share price a takeover of the target company will be more expensive, and perhaps uneconomical, for a raider. When attempting to obtain sellers of the target company's shares the raider is basically saying it can improve on the economic performance of the target company.

The obvious way for a target company to increase its share price is to improve its economic performance and to inform the target company's shareholders and the market of this fact. (56)

The target company may be able to increase its share price by the following:

(i) Selling assets which are not integal to the continuing profitability of the target company. Rationalising underperforming businesses. A raider will have no hesitation in undertaking such rationalisation. Rationalisation may include disposal of: non production real estate holdings, portfolio investments in other companies, businesses consistently generating earning below the target company rate of return on investment, luxurious head office premises and "orphans" that is businesses which bear little relevance to the mainstream activities of the target company. This frees up funds that may be used to give benefits to shareholders.

(56) S. Lofthouse supra n.28 page 41. P. Mason supra n.27 page 4. "The problem with maximising performance in order to avoid a bid is that this may place greater emphasis on short-term strategies rather than long-term objective" - S. Higgs, W. Chant, and R. Halstead supra n.27C page 4.

(ii) Monitoring the target company's gearing. If it is too low then it should be increased to enable the company to obtain extra funding for development or to give benefits to shareholders. Equity is the most expensive form of capital, the market may become flooded.

(iii) Utilising tax losses. The value of tax losses is directly related to how quickly they can be absorbed.(56A)

A target company's share price may also be affected by the target company's price earnings ratio ("P/E ratio") (57). A company's P/E ratio will normally be higher the better its management is thought to be, the greater its growth prospects, the lower its financial risks, the greater the stability of its earnings.(58)

(56A) R.A. Ross supra n.27D pages 9-11.

(57) A P/E ratio gives a measure of the rate at which earnings are being capitalised. A P/E of 20 means that investors are willing to pay 20 times current earning to purchase a share. S. Lofthouse supra n.28 page 41.

(58) S. Lofthouse supra n.28 page 41.

One commentator[59] has suggested two ways of increasing a target company's P/E ratio:

(i) Separately floating off part of a target company's activities if the management of the target company believes such separate activity is likely to command a high P/E ratio. [60]

(ii) Keeping the market well informed when it appears to be attaching too low a price to a target company. [61]

The target company must realise that in certain circumstances a top share price in the stock exchange context may not be a deterent to a raider who seeks to takeover the target company for strategic reasons or because it is considering a different time horizon.[61A]

If the Directors of a target company believe the target company's shares are at too low a price they may advise the market of their belief,[62] and may, to illustrate their confidence in that belief, state that the Directors intend to increase the number of shares in the target company they own.[63]

(59) S. Lofthouse supra n.28 page 41.

(60) The commentator illustrated this by stating that the price of Clabir Corporation, a U.S. conglomerate, more than doubled after it spun-off 33 per cent of its subsidiary General Defence.

(61) S. Lofthouse supra n.28 page 41.

(61A) S. Higgs, W. Chant and R. Halstead supra n.27C page 3.

(62) Recently illustrated by the newspaper clipping concerning Landmark (The Evening Post 26/6/85). The article alluded to the possibility that a raider may be interested in the shares of Landmark and may want to force the price down to make a takeover bid.

(63) The writer believes this action was undertaken by the Directors of Fletcher Challenge Corporation Limited in late 1984 or early 1985.

The writer believes informed shareholders are more likely to take cognizance of the Directors of the target company and their recommendations if a takeover bid occurs and comprehensive and reliable information given to shareholders is an essential strategy in today's information society.[63A] Credibility is critical; therefore frankness in disclosing bad as well as good news should be persued.[63B]

3.30 Articles of Association:

3.31 Shark Repellants:
The use of strategy to introduce measures to fend off a would-be raider, a shark, is in takeover jargon called "shark repellants"[64]

(63A) See also the use of top advisors for information dissemination to interested parties (Paragraph 3.16 of this paper). P. Mason supra n.27 page 4. Information to include well presented annual and interim reports and announcements from time to time of developments affecting the company.

(63B) R.A. Ross supra n.27D page 12.

(64) TIME 4 March 1985 page 35 and TIME 6 February 1984 page 61. Roger S. Aaron "Corporate Acquisitions in the United States" Page 60. A paper presented in a seminar on Investment in the United States organised by the N.Z. Society of Accountants and the N.Z. Law Society held August 1985. R.S. Aaron is a partner in the firm Skadden Arps Slate Meagher and Flom. C.G.G. Hogg supra n.6 page 121-122. The use of "shark repellants" has been criticised (eg see Article by Felix G. Rohatyn "Junk Bonds and Other Securities Swill" The Wall Street Journal 18th April 1985) and the Tender Offer Reform Bill 1984 in USA if enacted would place severe restrictions on these defensive tactics. The Tender Offer Reform Bill 1984 largely came about as a result of the U.S. Securities and Exchange Commission Advisory Committee Report of Recommendation on Tender Offers dated 8th July 1983. The Committee recommended the prohibition of shark repellant measures where they erect unduly high barriers to changes in corporate control (recommendation 35) and recommended to the extent that "shark repellants" were not prohibited that they be required to be ratified by shareholders every three years.

There are "shark repellants" which involve the target's Articles of Association:

(i) A Classifed Board of Directors:

A classified Board of Directors is divided into classes (usually three classes) which serve staggered terms. It is normal for this three year rotation term for Directors to be in a Company's Articles of Association. This structure in the United States attempts to make it more difficult to unseat the entire Board at once.(65)

However, in New Zealand such a measure is virtually negated by the right of a person or persons holding 10% of a company to call an extraordinary general meeting of shareholders (66) and the fact that Directors may be removed by ordinary resolution of a company before the expiry of the Directors period of office, notwithstanding the Company's Articles of Association or any agreement between the Company and the Director.(67)

(65) R.S. Aaron supra n.64 page 50; C.G.G. Hogg supra n.4 page 121; TIME - 6th February 1984 page 41; Sullivan and Cromwell supra n.27D, page 28.

(66) Section 136 of the Companies Act 1955.

(67) Section 187 of the Companies Act 1955.

A raider (if controlling or having the support of the majority of the target company) may remove directors [68] and appoint new directors to the target company's board, therefore enabling the raider to control the Board of Directors of the target company.[69]

However, a classified Board of Directors can be effective if the target company has restricted voting rights [70] and the maximum number of Directors for the target company as stated in its Articles of Association does not allow many additional Directors to be appointed.[71]

(68) Section 187 of the Companies Act 1955 was threatened to be used by Equiticorp, the new minority (40%) shareholder of Feltex, to remove an existing Director of Feltex. (see The Dominion 7th May 1985, page 12).

(69) However procedural limitations (eg nomination requirements) may be implemented (see paragraph 3.31(iv) of this paper). However see Plaza Security Co. v. O'Kelley, No. 7932 (Del.Ch. March 5 1985), aff'd No. 79, (Del. March 1985). A U.S. Court invalidatd a target company's Articles of Association that put substantial procedural limitations on the solicitation of shareholder consents to remove an incumbent Board of Directors. This information was obtained from a Memorandum by Fried, Frank, Harris, Shriver and Jacobson, a New York law firm headed "Tender Offer Defensive Tactics : A year of Change and Controversy" dated 11th April 1985 (hereinafter referred to as "Fried Frank Memorandum").

(70) For example, NZFP, any one shareholder has a nominal 15,000 share vote irrespective of the number of shares held. See paragraph 3.91 of this paper.

(71) This assumes the raider has not the ability or support to remove directors under section 187 of the Companies Act 1955. In the BIL-Emco circumstances BIL nominated 5 additional Directors as Emco had 7 directors and its Articles of Association allowed for a maximum of 12. (See The Dominion 7th May 1985 page 12).

(ii) Supermajority Provisions:

These are provisions in the Articles of Association that a merger or sale of substantially all of the company's assets or other transactions resulting in a change in corporate control must be approved by at least say 70% to 75% (a supermajority) of the shareholders of the target before it can take effect.(72)

The writer knows of no New Zealand company having yet adopted supermajority provisions although there seems no present legal impediment to their adoption by a Company.(73)

An example of a supermajority provision would be that, in the Articles of Association of the target company, there was an Article which allowed the Directors to refuse to register the transfer of shares to a proposed transferee if it was apparent that the shares of the company or any class thereof would be held or beneficially owned as to 50% or more by the transferee, except if such transfer is approved by the company in general meeting by a supermajority of 70% of those entitled to vote (excluding the transferee).(73A)

(72) TIME - 4th March 1985 page 35; TIME - 6th February 1984 page 41; C.G.G. Hogg supra n.4 page 121; R.S. Aaron supra n.64 page 60; and Sullivan and Cromwell supra n.27D page 28. This is one of three defences that were the most popular anti-takeover measure adopted by U.S. companies during the fourth quarter of 1984 - Mergers and Acquisitions (Winter 1985) Volume 19 Number 4 R.92. See also J.C. Coffee Jr "Regulating The Market for Corporate Control : A Critical Assessment of the Tender Offer's Role. In Corporate Governance" (1984)84 Columbia Law Review No. 5 page 1262-1263 (US).

(73) See however paragraph 3.91 of this paper a discussion of "loading" of voting rights by a target company in its Articles of Association.

(73A) See paragraph 453(1) of the Stock Exchange Code which states Articles of Association of listed companies shall NOT provide for any restriction on the right to transfer any shares or for the Directors to have power to decline to register a transfer except in certain limited circumstances. The described Article would be in breach of paragraph 453(1) of the Stock Exchange code.

An alternative supermajority provision may be drafted such that the Directors may not sell substantially or all of the company's assets or issue a substantial number of shares for the purchase of businesses or cause the target company to enter into a transaction or series of transactions resulting in a change in corporate control unless a supermajority approval vote of shareholders is received.(73B)

(iii) Contingent Supermajority : "Fair-Price" Provisions:
These are provisions in the Articles of Association that a merger or other business combination with a "significant shareholder" must be approved by a supermajority shareholder vote unless public shareholders receive a certain minimum price for their shares or approval to the merger or other business combination is obtained from the Directors of the target company.(73C)

(73B) This type of provision could be used by a listed company (in fact paragraph 448 of the Stock Exchange Code could be expanded).

(73C) Sullivan and Cromwell supra n.27D pages 28-29. This was another of the three defences (fair price, staggered Boards and supermajorities) that were the most popular anti-takeover measure adopted by U.S. companies during the fourth quarter of 1984 - Mergers and Acquisitions (Winter 1985) Volume 19 Number 4 R.92.

This particular strategy in the U.S. has been developed to be an impediment to a "two-tiered" takeover offer followed by a "freeze-out merger"(73D). A "two-tiered" takeover offer is an offer which offers a higher price for the first percent of the target company's shares sold to the raider (the percent being normally that required to give the raider greater than 50% of control of the target company) and the balance of the shares sought (normally a further percent) are offered a lower purchase price. This "two-tiered" takeover bid is designed to stampede sellers to sell their shares in the target company to the raider to receive the higher price whilst it is available. Once the raider has sufficient control of the target company it then seeks to implement a "freeze-out merger", whereby the raider is in control of the target company procures the target company's agreement to merger with the raider issuing shares for the purchase. The minority shareholders of the target company are "frozen-out of decision making".

The writer is unaware of: a "two-tiered" takeover offer being made, a blatant(73E) "freeze-out merger" taking place, or a target company adopting "fair-price" provisions, however there seems no present legal impediment to any of the above taking place.(73F)

(73D) Sullivan and Cromwell supra n.27D page 29.

(73E) The writer believes this type of merger takes place, especially undertaken by unlisted company's which takes over a listed company and then procures that the unlisted company is merged or its businesses are purchased by the listed company ("back-door listing").

(73F) Depending on the exact drafting of the "fair price" provision (see n.73A and n.73B) such provision may or may not be available to a listed target company governed by the Stock Exchange Code.

(iv) Nominating/Removal Directors Procedures:
A target company may adopt provisions in its Articles of Association that provide for a complicated and "early warning" system for the nomination of persons to be Directors of the target company. Such provisions would prevent "surprise nominations" at annual general meetings.(73G)

Such provisions are of limited effect having regard to the ability of a shareholder, controlling or having the support of the holders of in excess of 50 percent of the voting capital of the target company, to remove the entire Board of Directors utilising Section 187 of the Companies Act 1955.(73H)

(73G) Sulllivan and Cromwell supra n.27D pages 31-32.

(73H) Section 187 of the Companies Act 1955. Restrictions may be placed on filling a casual vacancy (see however Fitzgerald v. Association Motorists' Petrol Co. Ltd [1936]NZLR 390 and Munster v. Cammell Co. (1882)21 Ch.D 183. See Plaza Security Co. v. O'Kelley No. 7932 (Del. Ch. March 1985), aff'd, No. 79 (Del. March 1985). A US Court invalidated a target company's Articles of Association that put substantial procedural limitations on the solicitation of shareholder consents to remove an incumbent Board of Directors (Information from Fried Frank Memorandum supra n.69).

A target company may adopt provisions in its Articles of Association that provide that, in the event of an ordinary resolution being proposed at a general meeting of the target company for the removal of a director, any shares held by that Director should carry weighted voting rights.(73I)

(v) Overseas Ownership Restricted:
A target company may adopt provisions in its Articles of Association that enable the Directors of the target company to refuse to register transfers in favour of "overseas persons" and, in some cases, to compel a transfer of shares by an overseas person.(73J) This can be justified if the Directors of the target company reasonably believe the emergence of an "overseas person" as a shareholder or the target company becoming an "overseas person" would prejudice the target company in its business operations.(73K)

(73I) Bushell v. Faith [1970]A.C. 1099.
D. Gonski and P. Kennan supra n.26A page 25.

(73J) D. Gonski and P. Keenan supra n.26A page 22. A recent example of an Australian company adopting such a provision is The Myer Emporium Limited. See paragraph 453(1)(d) of the Stock Exchange Code. The adoption of Articles along these lines is common in New Zealand and was made reference to recently by the Chairman for CPD when a mystery, perhaps overseas raider was a possibility (Evening Post 6/8/85 page 21).

(73K) D. Gonski and P. Keenan supra n.26A page 23.

3.22 Disclosure of Beneficial Interest of Shareholding:

As a raider of a target company may build up a shareholding in the target company by using nominees, the target company should consider ensuring that its Articles of Association requires a nominee to disclose who the beneficial owner of shares held is and failure to disclose such information disenfranchises the nominee from voting on the target company's affairs.(74)

3.40 Employment Contracts (Two further shark repellants):

Two further "shark repellants" involve types of employment contract with the management of the target company.

(74) L. Goodman - supra n.28 page 186.
The writer believes the Stock Exchange Code (paragraph 428) does not preclude such a provision in the Articles of Association of a company listed on the New Zealand Stock Exchange.

Paragraph 428 states:

> "Every member being entitled to vote under the provisions of the Articles of Association shall be entitled in respect of those shares on which no call is in arrears:
>
> (a) On a show of hands, to one vote;
> (b) On a poll, to one vote for each unit of capital reduced to a common demoninator (Emphasis added by the writer).

The Chairman of the Securities Commission, C.I. Patterson (supra n.3 page 29), has indicated that the Securities Commission recommended that the law be amended so that disclosure of beneficial ownership should be required when a nominee shareholder attains 5% of the issued shares of a company. This recommendation has yet to be enacted into legislation.

3.41 Golden Parachutes/Silver Wheelchairs[74A]:

These are contracts made by the target company with key executives (including directors) where the key executives receive a substantial payment of some kind if they lose their jobs as a result of a change in corporate control.[75]

In New Zealand approval by a company in general meeting is required for payments to be made to a Director for loss of office.[75A] The writer does not know of any "golden parachutes" issued by New Zealand companies.

3.42 General Service Contracts:

Key management (including directors) of the target company may be given long-term service contracts. Such long-term service contracts may have the effect of discouraging a takeover since it complicates the removal of such key management.[76] Breaching the contracts costs the raider and the benefit is to the key personnel of the target company.

(74A) "Silver Wheelchairs" was an expression used by Peter Dodd when presenting his paper "The Financial Economics View of Regulation of Mergers & Takeovers" supra n.3.

(75) TIME - 4th March page 61; C.G.G. Hogg supra n.4 page 122; R.S. Aaron supra n.64 page 60; J.C. Coffee Jnr supra n.72 pages 1262-1264.

"Such agreements, which are now a standard part of many top-level employment contracts, ensure corporate officers that they will be paid off if the company that buys their firm fires them or reduces their power. These bonuses can reach $10 million for the chairman of a larger company" - TIME 4 March 1985 page 35.

However the Tax Reform Act 1984 in the U.S. has affected the attractiveness of "golden parachutes" in the U.S. F.B. Weil and R.W. Wood "New Taxes Tarnish Luster of Golden Parachutes" (Winter 1985)19 Mergers and Acquisitions 4 page 54.

(75A) See Sections 191 to 194 of the Companies Act 1955.

(76) R.S. Aaron - supra n.64 page 61; C.G.G. Hogg supra n.4 page 122; C.W. Forbes supra n.24 Chapter 2.

"There is nothing inherently objectionable in a company's execution of a long term service contract with a director in order to retain his services." (77)

However service contracts with the Directors of a target company will be invalid if they are:

(i) Not entered into in the best interests of the company; or

(ii) entered into specifically for the purposes of preventing a takeover bid.(78)

The Companies Act 1955 does require some disclosure in the accounts to be laid before every company in general meeting of the amount of remuneration received by the Directors for their services during the Company's financial year.(79)

(77) The Securities Commission Report supra n.6 para 5.6.1.

(78) Hogg v. Cramphorn supra n.27. See Weinberg and Blank supra n.27 para 2447 - Also if the Directors do act with such an improper purpose it may be validated by obtaining the approval of the shareholders in general meetings so long as the Directors believed the service contracts were in the best interests of the company (it is desirable for the Directors concerned not to vote at the general meeting).

(79) Section 197 of the Companies Act 1955. See also Section 196 of the Companies Act 1955).

Section 26 of the Companies Act 1967 (U.K.) requires that a copy of every directors service contract must be available for inspection by members at the Company's registered office, unless the contracts expire within one year or are determinable within one year without the payment of compensation.

In the United Kingdom under their Companies Act directors service contracts for periods longer than five years are invalid unless approved by the Company in general meeting.(79) The writer understands therefore that such service contracts are automatically extended for the full five year term at the end of each day, therefore whenever a takeover is made and concluded there will be a five year term to be completed, or to be compensated for if the contract is breached.(80)

To the writer's knowledge service agreements are presently not commonly undertaken as a defence to a takeover, and any long term agreement (over 5 years) has a tendancy to be seen as blatantly self-serving.(81)

(79) Section 47 of the Companies Act 1980.

(80) Discussion Mark Bucknill, a lecturer at the Victoria University, Wellington.

(81) C.W. Forbes supra n.24 page 41.

3.50 Voting Agreements between Shareholders

One of the simplest defence strategies is for two or more shareholders, each holding insufficient shares to secure effective control, to enter into an agreement in terms of which their joint holdings are to be voted as a block and may not be sold separately.(82)

Large shareholders may be given seats on the Board of Directors thereby hoping to tie their loyalty to the present management.(83)

It may involve two companies having interlocking shareholding, however not necessarily.(84)

Such voting agreements may state that decisions as to the sale of the shares which are subject to the agreement, or the exercise of voting rights, must be made unanimously (with arbitration in the event of a conflict) or perhaps by majority of the shareholders in number or in value of the shares contributed.(85)

(82) Weinberg and Blank supra para 2404, S. Lofthouse supra page 43, and A. Vrisakis and G. Samuel supra n.33 page 7. However parties to a voting agreement may fall out - see for a description of such problems Greenhalgh v. Ardene Cinemas [1946]1 ALL E.R. 512 (C.A.).

(83) S. Lofthouse supra n.28 page 43.

(84) S. Lofthouse supra n.28 page 43.

(85) Weinberg & Blank supra n.27 para 2404.

It is likely such voting agreements are entered into in collaboration with or with the co-operation of the Directors of the target company because if two or more shareholders wish to exercise effective control of a company they must do it through the Directors, and therefore the Directors must either be people whose appointment they have secured or the existing Directors of whose policies they approve. [86]

Clearly two shareholders acting pursuant to such voting agreement would normally be regarded as "in concert" [87] in terms of the Stock Exchange code. [88]

(86) Weinberg and Black supra n.27 para 2404.

(87) See paragraph 613(4) of the Stock Exchange Code which states "Persons acting in concert include those who, pursuant to an agreement or understanding, whether formal or not, actively co-operate through the acquisition by any of them of shares in a company to obtain or consolidate control of the company."

(88) In the United Kingdom because they have a mandatory offer requirement under their Stock Exchange code (if over 30% of the target is acquired), then a person or persons acting in concert are required to make a general offer to all shareholders and therefore if further shares are purchased after concluding a voting agreement a mandatory offer may be required to be made - See Weinberg and Black supra n.27 para 2404.

The most publically known voting agreements are between the companies Wattie Industries Limited, ("Wattie"), Goodman Group Limited ("Goodman") and New Zealand Forest Products Limited ("NZFP").

There are two agreements, one between Goodman and NZFP and one between Wattie and NZFP.[89]

The overall effect of the agreements is as follows:[90]

(a) Wattie:

(i) Goodman will not hold more than 35% of Wattie.
(ii) NZFP will not hold more than 24.9% of Wattie.
(iii) NZFP will vote its shareholding in accordance with the recommendations of Wattie Directors at general meetings of Wattie.
(iv) NZFP has the right to appoint two directors to the Wattie Board.

(89) The Commerce Commission Decision (dated 29th May 1985) 114A. This decision dealt with the purchase of shares in Dominion Industries Limited by Wattie Industries Limited sets out the basic terms of the Agreements. The Commerce Commission have refused a request under the Official Information Act 1982 by letter dated 17th June 1985 to disclose copies of the agreements on the ground that the agreements were supplied in confidence to the Commission and disclosure would prejudice the supply of similar information in future.

(90) The Commerce Commission Decision (dated 29th May 1985) 114A.

(b) Goodman:

(i) Wattie will hold not more than 35% of Goodman.
(ii) NZFP will not hold any shares in Goodman.
(iii) Wattie will vote in accordance with the recommendations of Goodman Directors at general meeting of Goodman.

(c) NZFP:

(i) Wattie maintain but will not hold more than 24.9% of NZFP.
(ii) Goodman will have no holding of shares in NZFP.
(iii) Wattie will vote in accordance with recommendations of NZFP directors at general meetings of NZFP.
(iv) Wattie has the right to appoint two directors to the NZFP Board.

3.60 Interlocking Shareholdings Between the Target Company and another Company or Companies ("Wheels")[90A]

Although a company may not, except in certain cases, acquire shares in its holding company [91] there is nothing to prevent two or more companies from acquiring and holding large - but not over fifty (50) per cent - blocks of shares in each other [92], although holdings exceeding 5 per cent of a company may have to be disclosed to the Stock Exchange.[93]

Such interlocking shareholders are generally announced to have the purpose of "forging a solid financial link."[94]

(90A) P. Mason supra n.27 page 5.

(91) Section 40 of the Companies Act 1955. And section 40 states any allotment or transfer of shares in a company to its subsidiary shall be void.

(92) Section 40 of the Companies Act 1955. See section 158 of the Companies Act 1955 for the meaning of "holding company" and "subsidiary".

(93) Paragraph 509(3) of the Stock Exchange Code, which states:

> "A listed company upon disposing of or acquiring, by whatever means, a beneficial interest in 5% or more of the issued shares of another listed company, is to advise the Exchange Immediately by telecommunication ..."

(94) Weinberg & Blank supra n.27 para 2406.

> "Where ... three companies (with a common board of directors or with boards which agree to act in concert) each have a holding of 26 per cent of the ordinary voting shares of each of the other companies ..., the board of directors of each company, with the assistance of the boards of the other companies, command a majority and therefore cannot be removed by the remaining shareholders. A similar situation arises in practice where two or more companies have substantial cross-holdings in each other even though these provide something less than a majority. Then there is so-called 'circular ownership': company A holds 40 per cent of the ordinary voting shares of company B, which holds 40 per cent of the ordinary voting shares of company C, which in turn holds 40 per cent of the ordinary voting shares of company A. The directors of all three companies, if they act in concert, can in practice prevent the removal of any of them by the other shareholders."[95]

One further, somewhat blatant, method is for a company to sell part of its undertaking to a separate company, distribute 51 per cent of the shares in the separate company to its own shareholders and cause the separate company to purchase shares in the company.[96]

(95) Paragraph 152 of the Report of the Jenkins Committee, Cmnd 1749 (U.K.).

(96) Weinberg and Blank supra n.27 para 2406.

A form of reciprocal shareholding is called 'pyramiding' which can be illustrated as follows:

> "A. holds 51 per cent of the shares of A. Co. B. holds 51 per cent of the shares of B. Co. They agree to form a new company, A. & B. Holdings, to take over their shares in A. Co. and B. Co., and enter into a voting agreement in respect of their shareholding in the new company. After the new company is formed, they sell 49 per cent of its shares to the public. In this way, while getting 49 per cent of their investment out in cash they retain voting control of both A. Co. and B. Co." (97)

Also a system ("pyramiding") used by United Kingdom mining houses and investment groups is where a group of small individual holdings (individual holding less than 10% but collectively between 15 percent and 50 percent) when held through a series of inter-related companies, all ultimately under the same management control, can confer effective control in a company where the shares are otherwise widely dispersed, geographically as well as regards numbers of shareholders. (98) The system can be effective because a comparatively low individual shareholding in a company, where other shareholders tend to be apathetic or do not combine together, and this can give a single group of people management control of that company; a small holding by that company in another company can again be sufficient to allow the same group to acquire management control of the second company, and so the control of a single management group can be established through a wide range of companies.(99)

(97) Weinberg and Blank supra n.27 para 2408.

(98) Weinberg and Blank supra n.27 para 2409.

(99) Weinberg and Blank supra n.27 para 2409.

A similar and even more simplistic, method is for two companies to acquire a large shareholding in each other.(100) This method has been utilised by Goodman and Wattie for some years, now joined by NZFP in a triangular shareholding.(101)

Recently Cable Price Downer Corporation Limited ("CPD") and Crown Corporation Limited ("Crown") obtained the necessary consent of the Examiner of Trade Practices to buy a 50% shareholding in each other, previously in 1984 Crown acquired a 24.7% shareholding in Crown while Crown took up 20% of CPD.

> "The 50% potential shareholding provides both companies with immediate ability to defend the other's share capital in the event of a market raid." (102)

This type, and especially this magnitude, of cross shareholding raises the question OF whether this is in the best interests of the shareholders of each company.(103) The Chairman of the Securities Commission, Mr Colin Paterson has been reported as stating:

(100) S. Lofthouse supra n.28 page 83.
It seems the South African mining houses are the leading proponents of this method.

(101) See for background from an accounting viewpoint - A.J.D. Moore "A Study in Cross Holdings" (1985) The Accountants' Journal February 1985 page 64.

(102) Linda Sanders in The Dominion 29/5/85.

(103) Peter O'Brien supra page 19. It may also cause accounting problems. (The Dominion 16/5/85 - Article by Linda Sanders.)

"I am inclined to go further and suggest that where there are cross-shareholdings by one group of companies in another, the voting rights should be in abeyance in respect of each holding. This would be consistent with the reduction of capital theory ... with reference to equity accounting."[104]

Also there is the danger that:

(i) the "friendly" shareholder (if there is no reciprocal shareholding) turns raider[105] or;

(ii) the "friendly shareholder is sought by a raider as a vehicle for obtaining the target[106].

Therefore some criteria in selecting the "friendly" shareholder include:

(a) Compatibility with the target company's Board of Directors and management.

(b) Assurance of resistance to offers for its shareholdings.

(104) The Evening Post 15 March 1985.

(105) S. Lofthouse supra n.28 page 42.

(106) An example was the proposed takeover by Robert Holmes A'Court of Asarco Inc. It was believed that Mr A'Court was interested in Asarco Inc. because it owned more than 40% of the Australia company MIM.

(c) An inability to acquire control of the target company itself.[106A]

(d) Relative invulnerability to takeover itself either because it is hopefully too big or it has a stable majority shareholder.[106B]

It is generally preferable for the friendly shareholder to acquire his shareholding by share market purchases. Placements can upset existing large shareholders and means the target company's Board of Directors has put a price on the shares.[106C]

(106A) See paragraph 4.12 of this paper "standstill" Agreements.

(106B) A. Vrisakis and G. Samuel supra n.33 page 5.

(106C) A. Vrisakis and G. Samuel supra n.33 page 5 and discussion on the paper.

3.70 Issue of Shares to "Friendly" Party[106D]:

This strategy is similar to interlocking shareholding but there is no cross shareholding.[107]

A number of situations can exist including:

3.71 Employees:

The issue of shares to employees is seen as furthering an employees' stake in the target company's development.[108]

The Directors of the target company hopes the employees will be sympathetic to the Directors of the target company and not welcome a takeover (especially if restructuring and retrenchment is possible).[109]

Such issues are commonly carried out by possible target companies, however such issues must not be made purely to thwart a takeover bid.[110]

(106D) Caution is required. Robert Holmes a Court (Australian takeover businessman) has shown that the Australian company MIM is vulnerable through the U.S. company Asarco which owns 44% of MIM. P. Mason supra n.27 page 5.

(107) Weinberg & Blank supra n.27 paragraph 2412.

(108) Weinberg & Blank supra n.27 paragraph 2412. P. Mason supra n.27 page 6.

(109) Weinberg & Blank supra n.27 paragraph 2412. P. Mason supra n.27 page 6.

(110) Hogg v. Cramphorn supra n.27

3.72 Employee Superannuation Funds:

An employee superannuation fund investing in shares of the target company is also furthering the interest of employees in the target company.(110A)

The trustees of the Company's superannuation fund are generally either employees of the Company or persons appointed by the Directors and will generally be receptive to the wishes of the Directors of the Target company.(111)

However the trustees, like all trustees, do have very special obligations so that the Directors may not be able to rely on their support in all instances(112), especially if the offer bid is generous.(112A)

3.72 Close Business Associate:

A target company may issue shares to a close business associate, the rationale being to further their close business association.(113)

(110A) There are certain limitations on the extent the fund can be exposed to its company's Securities (Superannuation Schemes Regulations 1983, Regulations 10(4) and 10(5)) and listed target companies also should be aware of paragraph 425(i)(a)(ii) of the Stock Exchange Code.

(111) Weinberg and Blank supra paragraph 2412 and P. Mason supra n.27 page 6. See also A.G. Brecher, S. Lazarus III, and W.A. Gray "The Function of Employee Retirement Plans as an Impediment to Takeovers" (1983) Volume 38 The Business Lawyer (US) page 503.

(112) Weinberg and Blank supra n.27 paragraph 2414.

(112A) A. Vrisakis and G. Samuel supra n.33 discussion on paper.

(113) For example the placement by Arnotts Limited of 6.1 per cent of its capital to Campbell Soup Company Inc. (The Dominion 10.4.85). Arnotts Limited, an Australian company, was under takeover threat and found a "friendly" party in the American company Campbell Soup Company Inc.

3.73 Vendor:

A target company may issue shares in consideration for the target company purchasing an asset or another company. The Directors may believe the new shareholders are "friendly".(114)

(114) Weinberg & Blank supra n.27 paragraph 2420. S. Lofthouse supra n.28 page 48.

See also Gearhart Industries Inc. v. Smith International Inc., 741 F.2d 707 (5th Cir. 1984). Gearhart Industries Inc. ("Gearhart") shareholders had received a tender offer from Smith International Inc. ("Smith"). While Smith's tender offer was pending, but after it has been enjoined by the district court for securities law violations, Gearhart agreed with Aetna Life & Casulty Company ("Aetna") to buy an Aetna subsidiary in exchange for shares in Gearhart. The United States Fifth Circuit on appeal refused to stop the purchase by Gearhart but instead remanded the case for factual determinations and set out what issues were to be examined.

> "It may be that Smith can present sufficient evidence to convince the Court that Gearhart directors who entered into the Geosource [Aetna's subsidiary] deal were interested, given circumstances such as the eight-day time span from contract to closing, the fact that Gearhart was in the throes of battle for control of the company at that time, and the retention in Gearhart management of voting control of all the new shares, a provision we think is particularly suspicious. If Smith can make its case for interested directors, then the burden is on Gearhart to convince the Court that the Geosource acquisition is fair to the Corporation." (page 76).

The District court never heard the case on remand because Gearhart and Smith reached a settlement agreement. (Information from Fried Frank Memorandum supra n.69).

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3.74 Overseas Shareholders:

An overseas shareholder who is "friendly" to the target company may be ideal in that the overseas shareholder can only obtain up to 25% of the target company without getting the necessary consent of the Overseas Investment Commission.(114A)

3.80 Defensive Merger ("White Knight")

A target company, fearing a takeover by a raider, may decide to undertake a defensive merger.(115)

(114A) Regulation 7 of the Overseas Investment Regulations 1974. The writer believes consent required by the Overseas Investment Commission is presently normally no certain protection to a target company from the "friendly" overseas company becoming "hostile" in light of the relaxed Commission and Government attitude to overseas investment in New Zealand. However it worked for AHI and ACI (see footnote 262). This may be more relevant for Australian target companies - P. Mason supra n.27 page 5.

(115) Wanvig v. Johnson Controls, Inc., No. 663-487 (Wins. Cir, Ct. March 29 1985). The Wisconsin Court held that the Directors of Johnson Controls Inc. in the face of a possible takeover threat had not breached their fiduciary duty in planning a merger with Hoover Universal Inc. without a shareholders vote, because no shareholder vote was required under Wisconsin Corporation law and the plaintiffs failed to show that thwarting the raider was the sole reason for the merger. (Information from Fried Frank Memorandum supra n.69.)

Such a defensive merger with a private third party company may involve:

(i) Swapping some shares in the target company for all the shares of the third party company.(116) This enables the shares of the target company swapped to be held by "friendly" shareholders.(117)

The management of the target company to ensure such "friendly" shareholders may arrange for a voting agreement to be entered into between the existing and new "friendly" shareholders in relation to the affairs of the Company and the target company's reaction in the event that a takeover attempt is made for the target company (as merged). (118)

(ii) The target company purchases another company for cash. (119) Such a move would be particularly attractive to a target company "cash rich". (120)

(116) Weinberg and Blank supra n.27 paragraph 2422. See paragraph 425 of the Stock Exchange Code for listed target companies. This paragraph sets certain restrictions on a listed company issuing share capital.

(117) A decision for such share swap may be questioned but it is unlikely that the Court will question the decision to share swap if management's decision was bona fide arrived at. Howard Smith Limited v. Ampol Petroleum and Others supra n.27 S. Lofthouse supra n.28 page 42.

(118) Weinberg and Blank supra n.27 paragraph 2422.

(119) Weinberg and Blank supra n.27 paragraph 2422. S. Lofthouse supra n.28 page 42.

(120) Weinberg and Blank supra n.27 paragraph 2422. S. Lofthouse supra n.28 page. 42

A target company may become "cash rich" for many reasons (for example by the sale of part of a company's business [121] or an investment shareholding [122]).

Decreasing the target company's "cash rich" position means the target company is less attractive to a potential raider.[123]

(121) Weinberg and Blank supra n.27 paragraph 2422.

(122) It is the writers belief that ACI in Australia would be seen as "cash rich" if ACI agreed to sell its shareholding in AHI to Carter Holt.

(123) Weinberg and Blank supra n.27 paragraph 2422. S. Lofthouse supra n.28 page 42.

Defensive mergers may deter a possible raider by reason of:

(a) Diversification caused by the merger may be unacceptable to the raider.[126]

(b) The enlarged size of the target may cause factors under the Commerce Act 1975 to be relevant.[127]

A target company may also search for a "white knight". A "white knight" is a company that rides to the aid of a target company in a takeover fight. The knight rescues the target company be agreeing to purchase it, or a significant part of it[128], on better terms than the raider would provide. The better terms may include a higher purchase price for the shares in the target company and assurances that the management of the

(126) Weinberg and Blank supra n.27 paragraph 2422.

(127) Weinberg and Blank supra n.27 paragraph 2422. S. Lofthouse supra n.28 page 42.

(128) For example Steel and Tube Limited rescuing Emco from BIL (The Dominion and Evening Post 6/7/85).

For such a merger that went wrong see Smith v. Van Gorkom No. 255, 1982 (Del. Jan 29 1985). The Delaware Supreme Court, in a 3-2 decision, found the Trans Union Corporation board of directors personally liable because it had acted grossly negligent in that failed to act with informed reasonable deliberation in agreeing to a $US690 million merger proposal by the Morman Group. The case has been strongly criticized, however, because there was no claim of fraud or improper motive. (Information from Fried Frank Memorandum supra n.69).

target company will not be fired or retrenched.[129] A target company may keep a list of potential white knights,[130] however approaching companies to act as "white knights" before a takeover bid appears in fact to precipitate takeover bids (a potential raider may be galvanised into action by the "white knight" rumour and once the Directors have indicated that they are prepared to merge the target company's directors may find it difficult to refuse a better offer from a raider).[131]

(129) TIME 4 March 1985 page 35. S. Lofthouse supra n.28 page 43.

(130) S. Lofthouse supra n.28 page 42.

(131) Weinberg and Blank supra n.27 paragraph 2422.
L. Goodman supra n.28 page 187.

However use of a "white knight" for a target may cause problems. If the "white knight" does not research the role it is expected to play in the target company before indicating its intention to play such a role the "white knight" may, when a takeover bid is made, decide to undertake a proper appraisal of the target company and delay in making such assessment may enable the raider to takeover the target company.(132) Alternatively, the white knight may not wish to be involved in a contested takeover battle or may simply lose interest in saving the target company.(133)

Also the use of a "white knight" may not always work for the target company in that the merged company may not be successful (therefore itself being vulnerable to a takeover). Although intended to save the jobs of the management of the target company on many occasions once the white knight has learned the ropes of the target company it employs its own people. (134)

(132) S. Lofthouse supra n.28 page 42.

(133) S. Lofthouse supra n.28 page 42.

(134) S. Lofthouse supra n.28 page 42.
The ultimate "white knight" strategy going wrong was in the United States where Bendix Corporation made a takeover attempt of Martin Marietta Corporation. Martin Marietta Corporation and United Technologies Corporation retaliated by making a takeover attempt on Bendix. Bendix believed it was losing the battle and linked up with a "white knight" Allied Corporation. The top management of Bendix eventually lost their positions in Bendix. (NEWSWEEK 4 October 1982). For a detailed description of this takeover battle see A. Sloan Three Plus One Equals Billions (Arbor House, New York, 1983).

3.90 Capital Reconstruction ("Poison Pills")(135)

3.91 Non-voting, Restricted or Weighted Voting Rights:
New Zealand target companies may create shares with non-voting, restricted or weighted voting rights.(136)

Such shares with non-voting, restricted or weighted rights must be issued in accordance with the target company's Articles of Association. This was confirmed in the case of Hogg v. Cramphorn Limited (137) where Buckley J. held:

(i) That since the Articles of Association state that every share was entitled to one vote only, the Directors did not have the power to issue new shares with ten votes, notwithstanding that there were Articles which stated that the shares of the particular company were under the control of the Directors who may allot or otherwise dispose of shares on such terms and conditions as the Directors think fit and that new shares shall be issued upon such terms and conditions, and with such rights and priviledges attached to such new shares as the Directors determine and with a special or without any right of voting.

(135) Poison Pill - a defense that makes the takeover so expensive or unattractive that the raider gives up the quest - TIME 4/3/85.

(136) For example NZFP's Articles of Association limits the vote of any one shareholder (no matter how many shares held) to a nominal 15,000 share vote (The Dominion 30/5/85). See however paragraph 428 of the Stock Exchange code set out in n.74 previously and the previous discussion on Classified Board of Directors in paragraph 3.31(i) of this paper. See J.C. Coffee Jr. supra n.72 page 1263. See Bushell v. Faith supra n.73I.

(137) [1967]1 Ch. 254.

and (ii) that, the power to issue shares was a fiduciary power, and if exercised for the purpose of forstalling a takeover bid, then such issue of new shares was invalid in the absence of a resolution of the Company in general meeting ratifying it.(138)

Some large United Kingdom companies have utilised the technique of issuing shares carrying no votes or restricted voting rights in exchange for acquisitions and by way of capitalisation issues.(139)

(138) Weinberg and Blank supra n.27 paragraph 2426.

(139) This enables the controlling shareholders to realise part of their shareholdings without reducing their proportion of voting power held by them.

Weinberg and Blank supra n.27 paragraph 2427 footnote 66.

It is believed that the issue of shares with non-voting or restricted rights, although allowable, is exceptionable because of institutional and investor resistance and dissatisfaction with a company issuing such shares.(140)

It is proposed that companies listed on the New Zealand Stock Exchange will be obliged to have Articles of Association which allow every shareholder entitled to vote, on a poll, to one vote for each share by the time of the next general review of the Stock Exchange Code in 1986. (141)

(140) Weinberg and Blank supra n.27 paragraph 2435. See also paragraphs 2428-2434 (inclusive) which discusses the arguments for and against legislation prohibiting or abolishing non-voting shares.

(141) Letter from the New Zealand Stock Exchange to members dated 12th July 1985 noting amendments to the Code effective 1 July 1985.

3.92 Issue of Convertible Securities:

Loan Stock:

Companies often issue loan stock which is convertible into equity share capital or which carries the right to subscribe for equity share capital.(142)

Such loan stock is normally issued primarily to raise capital relatively inexpensively(143), however it may have the purpose of being either a useful form of consideration to offer in a takeover bid or making the target company less attractive to a potential raider.(144)

(142) Weinberg and Blank supra n.27 paragraph 2425. A. Vrisakis and G. Samuel supra n.33 see such securities as a target company "confusing the share structure" (page 4).

(143) The interest paid may be deductible by the target company - Section 194 of the Income Tax Act 1976 as opposed to dividend payments which are not deductible.

(144) Weinberg and Blank supra n.27 paragraph 2425.

Terms may be inserted in the loan stock, whether convertible or not, such that repayment is required at par or at a premium on the completion of a takeover.[145]

A target company may issue loan stock with a low issue price being substantially discounted from the par value, however with a provision for repayment at par on a takeover, therefore the worth of the target company is less to a raider than to the existing shareholders.[146]

(145) Weinberg and Blank supra n.27 paragraph 2438. See also Gearhart Industries Inc. v. Smith International Inc., n.114 Gearhart Industries Inc issued debt securities convertable to equity upon the occurent of a tender offer. Such issue was challenged but was upheld in the Court, no evidence of self-interest was established on the part of Gearhart Directors and the transaction was fair to the Corporation. Evidence of fairness included:

(i) respected financial and investment banking counsel was retained;
(ii) the transaction was approved before Smith International Inc's tender offer;
(iii) the yield on the debt securities was reasonable at the time;
(iv) the conversion agreement was an integral part of the offering because it helped alleviate uncertainty as to Gearhart's future and the conversion lent flexibility to the investors and allowed Gearhart to convert debt to equity;
(v) the exercise price of conversion, approximated the market price of Gearhart stock before Smith International Inc.'s buying commenced;
(vi) credible business reasons for issuing debt were found, such as to retire old debt and raise new capital; and
(vii) arms lengths bargaining between sophisticated businessmen had occured.

(Information from Fried Frank Memorandum supra n.69).

(146) Weinberg and Blank supra n.27 parargraph 2438. S. Lofthouse supra n.28 page 43.

Also loan stock convertible to shares upon a takeover add to a raider's problem as the amount of equity to be acquired could be considerably expanded.[147]

3.93 Options for Shares:

(i) To Third Parties (Example of a "poison pill")

The issue by a target company of an option or options for shares has recently been utilised by Waitaki - NZR Limited ("Waitaki") when BIL made a bid for 15% of the shares of Waitaki.

Waitaki Directors, in response to the partial takeover, announced Waitaki was issuing an option for 20 per cent of the capital of Waitaki to an unnamed third party at an undisclosed cost in accordance with its Articles of Association.[148] This would force BIL to buy extra shares if BIL wished to obtain its 15 per cent shareholding.[149]

Shortly after the announcement The New Zealand Stock Exchange countered by suspending Waitaki shares "pending clarification of certain aspects of the announcement."[150]

(147) Weinberg and Blank supra n.27 paragraph 2438.

(148) Evening Post 16/4/85.
The Waitaki Directors also repeated their "don't sell" recommendations in response to the BIL "stand in the market" and stated reasons for their belief that BIL move was not in the best interests of Waitaki shareholders.

(149) Evening Post 16/4/85.
Additional cost of $6 million at then current prices.

(150) The Dominion 20/4/85.

The Stock Exchange Code states that a company must not issue shares that will effectively change control (151) of a company without express shareholder approval.(152)

One commentator stated that the option issue by Waitaki was criticised as "an effective major dilution of capital, as it is assumed the options will convert to ordinary shares at some time". (153)

It was reported that BIL management:

(i) was considering action in the High Court to resolve what it considers an "absurd and rediculous" defensive move; (154)

(ii) stated "this thing [the option] bypasses all the genuine Waitaki shareholders, who now find that their company is delisted because of this action". (155)

(151) Effective control is regarded as possibly being affected by an issue in which any one beneficial interest acquires 10% or more of the voting capital of the company (paragraph 311(4) of the Stock Exchange Code). See N.L. Scheinkestel "Control - How to Regulate an Elusive Concept" 2(1984) Company and Securities Law Journal No.4 page 251 (Aust).

(152) Paragraph 311 of the Stock Exchange Code.

(153) The Dominion 20/4/85

(154) Ibid.

(155) Ibid.

"From the company's [Waitaki's] point of view it was an excellant defensive move. While the Stock Exchange expressed its displeasure and suspended quotation of the shares (and flushed out who the shares were being issued to [Wesfarmers] and it appeared to be only able to urge - rather than command - that the company seek permission of its shareholders to issue the shares". (156)

"... the objections [to the Waitaki option announcement], ... appeared to be the size of the issue and the proposal not to treat all shareholders equally rather than the fact the company was raising money or issuing shares". (157)

(156) The Dominion 4/5/85

(157) The Dominion 20/5/85

Waitaki's option issue has presently stopped BIL partial takeover bid, BIL holding approximately 7% of Waitaki as at 28th June 1985 (158)

The target company, if contemplating such an option issue, should ensure it is in accordance with its Articles of Association.(159)

(ii) Options to Existing Shareholders

The use of issuing options to existing shareholders has been raised by people especially as a defence against partial takeovers.(160) Partial takeovers are very important as a shareholding of 30 - 35% would be considered as a controlling interest in most listed companies.(161)

(158) O'Connor Grieve & Co 1985 Mid-Year Review dated 28th June 1985 page 28

(159) See Hogg v. Cramphorn supra n.27.

(160) A paper "The Use of Options As a Defence Against Partial Takeovers" (hereinafter referred to as "Lloyds") by Lloyds International Limited supplied to the writer on the 25th January 1985.

(161) Lloyds ibid page 1.

The issue of options free, non-renounceable and not separable from the shares in respect of which they are issued, and convertible to equity[162] on completion of a takeover would be a strategy open to a target company. This would create the same problems for a raider as discussed for loan stock previously.[163]

(162) The equity shares issued at par (i.e. assumed to normally be at a discount from the target's present trading price) and the amount payable on subscription being small (between one cent and par).

(163) See Moran v. Household International Inc. ("Household") No. 7730 (Del. Ch. Jan.29 1985) Delaware Court of Chancery. Household's preferred stock rights dividend plan allowed the shareholders to buy $200 worth of the merged company for $100 in the event of a hostile takeover. The Judge held the plan was legal, not intended for entrenchment of management and serving rational corporate purpose. American Bar Association Journal (1985) Volume 71 May 1985 page 122 and Fried Frank Memorandum supra n.69. Both the U.S. District Court for the District of Nevada in the case of Horwitz v. Southwest Forest Industries Inc. No. CV-R-84-467-ECR (D. Nev. Mar.19 1985) and the U.S. District Court for the Eastern District of New York in the case of APL Corp. v. Johnson Controls Inc., No. 85-C-990 (E.D.N.Y. Mar.25 1985) have refused to grant preliminary injunctions against similar preferred stock rights dividend plans. (Fried Frank Memorandum supra n.69). It has recently been reported that McDonalds, the US fast food chain, has granted to existing shareholders the right to acquire shares in the company at half price if an individual or a group acquired 20 per cent or more of McDonalds shares or announce a tender offer for 30 per cent or more (The Dominion 16/9/85 page 16).

It is believed it is difficult to defend a company against a partial takeover, even when it is at an obviously inadequate price.(164) Generally, a partial takeover launched from a shareholding of 20% has a high likelihood of success even if the offer price is widely regarded as inadequate.(165)

The use of options to prevent a partial takeover is more limited in New Zealand than Australia because of New Zealand's basically unregulated takeover code. In Australia, generally a person/company would be prevented from exercising an option if that person/company would increase his/her/its shareholding beyond 20%.(166)

(164) Lloyds No.160 page 1.

(165) Lloyds ibid page 2.

(166) Lloyds ibid page 4. The Australian Acquisition of Shares Code allows a shareholder to increase its shareholding beyond 20% only by way of a takeover offer (either full or partial) or through a limited number of special exemptions. Options can be exercised to increase a shareholding beyond 20% only if they were acquired during the course of an unconditional offer for all shares.

3.94 Split the Shares:

A target company with a "high" share price may consider splitting the shares from one $1 shares to two $0.50 shares [167] or from one $0.10 shares to ten $0.01 [168] or whatever split is seen as desirable.

The writer understands that this strategy is normally explained by the rationale that this will naturally lower the target company's share price and make shares in that target company more accessible to individual investors who may only have limited resources to purchase shares, especially as shares in companies listed on the New Zealand Stock Exchange are normally purchased in multiples of one hundred shares.

(167) This was undertaken by Allflex Holdings Limited in 1984, and Cory Wright and Salmon Limited in 1985.

The writer does not believe that these share splits were intended as a defensive measure against a possible takeover of these companies.

(168) This is to be undertaken by Jarden Corporation Limited in 1985.

One commentator believes there is little logic to support the belief that share splitting increases a target company's share price (per cent of nominal value) and detailed U.S. studies suggest such belief has no empirical validity. (169) That commentator believes share splits are often associated with good news about dividends, prospects, property revaluation and so on, and any casual evidence adduced for this strategy can usually be explained in this manner. (170)

(169) S. Lofthouse supra n.28 page 42.

(170) S. Lofthouse supra n.28 page 42.

3.100 Raise the Dividend:

Some target companies may be operating with excessively high dividend cover.(171)

A programme of lowering the cover over a number of years may be contemplated.(172) Shareholders are likely to favour a company with a faster than usual growth of dividends paid to shareholders.(173)

Naturally a company would not wish to increase the dividend payable to shareholders if it would cause cash flow problems.(174)

The market rewards predictability and growth.(174A) Therefore unexpected dividend cuts or a fluctuating dividend policy are not appreciated.(174B)

(171) S. Lofthouse supra n.28 page 42.
High dividend cover means that the company is retaining profits and that such retained profits equal a "high" number of years multiplied by the amount required to be paid to meet the company's present divident payment to shareholders.

(172) S. Lofthouse supra n.28 page 42.

(173) S. Lofthouse supra n.28 page 42.

(174) If the target company does not have adequate resources to finance the increased dividend such increase may be a breach of duty on the part of the Directors of the target company - see Y.F. Danziger "Remedial Defensive Tactics Against Take-overs" (1983)4 The Company Lawyer (UK) 1 page 4 and Weinberg and Blank supra n.27 paragraph 2465. A usual dividend policy is to pay out from 45% to 55% of after tax operating profits (R.A. Ross supra n.27D page 13).

(174A) R.A. Ross supra n.27D page 13.

(174B) R.A. Ross ibid.

A planned programme over a number of years for lowering the dividend cover may be desirable to lessen possible cash flow problems and allow the company to increase the dividend payable if a takeover bid was made for that company.(175)

3.110 Bonus Issue Made:

As with the question of a target company raising the dividend a bonus issue may be contemplated.

Bonus issues are particularly attractive to investors because of their capital gain, presently tax free. Bonus issues are now somewhat "expected" from the major New Zealand companies.

In theory bonus shares should lower the share price of the Company in proportion to the issue of the bonus shares.(176) However, in practice, the share price normally is not discounted to the same proportion of bonus issue.(176A)

The issue of bonus shares can be a defence strategy as it invariably makes the target company more expensive (more shares to purchase and a greater dividend commitment).(177)

(175) S. Lofthouse supra n.28 page 42.
Waitaki - NZR when making an interim dividend subsequent to the bid for a 15 % shareholding by BIL announced an interim dividend of 7 cents per share of which 3.5 cents was tax free (1984 5.5 cents per share all tax free) - The Dominion 8/5/85 and Emco announced an early dividend after the bid by BIL - The Dominion 7/5/85.

(176) After the budget in August 1985 the writer believes there will be an increase in bonus issues, rights issues and dividend investment schemes due to the taxation consequences.

(176A) One commentator has stated: "Forget theory, bonus issues get headlines and share prices respond. They are a very potent weapon and a much better means of increasing the dividend rate" (R.A. Ross supra n.27D page 14).

(177) Recently used by Emco - "Emco had made a one-for-five payment and early dividend payment as a defence to the BIL bid" (The Dominion 7/5/85).

Bonus issues, rights issues at a deep discount, and, the writer believes, dividend reinvestment schemes are or will be popular with New Zealand shareholders and are seen by shareholders as a tangible expression of the target company's interest in its shareholders and they are normally an indication of the Director's confidence in the future.(177A)

3.120 Management Buy-Out

The management or a group of management, particularly if they already hold a significant shareholding in the target company, may believe that the share price is unrealistically low and may make a bid for all or part of the target company.(178)

The management may state that the bid will emphasise their commitment to the target company and it would give stability for the long term growth of the target company. (179)

Such management buy-outs are now quite common in the United States and sometimes such a buy-out is financed by giving securities over the target company's assets called "a leveraged buyout". Such leveraged buy-outs using the company's assets are illegal in New Zealand as it would mean the Company is assisting in the purchase of its own shares.(180)

(177A) P. Mason supra n.27 page 4.

(178) Seen recently in New Zealand in relation to Mainseal Limited, Freightways Limited, Wilkins & Davies Limited and Lion Breweries Limited. One commentator, Linda Sanders, The Dominion 6/7/85, has suggested that following the Ceramco - Atlas merger "it is possible something similar [a management buyout] could ultimately happen to Ceramco".

(179) The Dominion 2/7/85 reported similar sentiments made by Douglas Myers concerning the bid for 10 percent of the share capital of Lion Breweries Limited by Tarragon Investments Limited (that company beneficially owned by Douglas Myers Managing Director of Lion Breweries Limited and John Fernyhough a Director).

(180) Section 62 of the Companies Act 1955. See for background discussion on this matter T. van Zijl "Share repurchase - should be it lawful in New Zealand?" (1984) The Accountants' Journal page 202.

Management in such circumstances should, however, expect to answer the obvious (yet seldom asked) questions:

(i) why had the Management involved in the buy-out not first, if not done so, informed the market that the share price was unrealistically low thereby giving the market and existing shareholders an opportunity to reasses the value of the target company shares or their holding (perhaps increasing their holding at the "cheap" price)?

(ii) what had the involved Management done, prior to the bid, to allow the market to reassess the shares of the target company (information, dividends, bonus issues etc)?

(iii) what has the involved Management done to show that it has not manipulated the low share price of the target company for their own advantage?

(iv) how does the involved Management justify their bid (a raider normally states it can operate the company more efficiently or economically - this reason will not normally be available to the involved Management as they operate the target company presently)?

3.130 Sell Assets/Loading Debts/Buy Assets
("Scorched Earth" or "Golden Jewel")

"Scorched earth" is a self-destructive strategy in which the target company seeks to discourage a takeover by making itself less attractive. (181) Some target companies have done this by selling the very assets the raider wanted (also called the "golden jewel strategy" (182)). In addition, a target may make itself unpalatable arranging for:

(i) substantial loans which fall due at once in the event the target company is acquired,(183) or,

(181) Time - 4/3/85 page 35.

(182) See Baigent v. B. McL Wallace supra n.26 Prichard J stated:
"It would, I think, be only in the most extreme case, if ever, that the Court would find that the decision of a board of directors to sell one of the company's assets was an abuse of power unless, of course, the directors obtained some personal advantage form the sale".

See paragraph 448 of the Stock Exchange Code which states:

"Any sale or disposal by the directors of the company's (or group's) main undertaking shall be subject to prior approval by shareholders in general meeting."

(183) P. Solman & Thomas Friedman - Life and Death on the Corporate Battlefield - How companies Win, Lose, Survive - Simon & Schuster 1982, page 114 noted Marathon Oil agreed to sell it's much prized oil and gas reserves to U.S. Steel if Mobil outbid U.S. Steel for Marathon. This was later ruled illegal however Mobil bid for Marathon was also illegal on anti-trust grounds. See also Thompson v. Enstar Corporation No. 7641 (Del. Ch. June 20 1984) and DMG, Inc v. Aegis Corporation No. 7619 (Del. Ch June 29, 1984). (Fried Frank Memorandum supra n.69).

(iii) a substantial purchase of assets or shares of a third party on terms unfavourable in the event the target company is acquired (184).

The Stock Exchange Code requires a company seeking to divest itself of the company's (or group's) "main undertaking" to make such sale or disposal subject to prior approval by shareholders in general meeting. (185). The sale of assets by the target company may have the following advantages.(185A):

(i) the target company loses its attractiveness to the raider;

(ii) the assets may be producing losses and the balance sheet and profit and loss statements may be improved by the asset sale;

(iii) the value placed on these assets by a third party may make the raider's takeover price (assuming a takeover raid has been made) appear inadequate.

(184) See also paragraphs 3.70 and 3.92 of this paper.

(185) See paragraph 448 of the Stock Exchange Code. This paragraph was amended as from 1 July 1985. Previously such sale of a company "main undertaking" only had to be ratified by shareholders in general meeting. See recently the criticism of the information supplied to shareholders by the Directors of R. & W. Hellaby Limited in relation to its sale of company assets (The Dominion 8/8/85 page 12).

(185A) S. Lofthouse supra n.28 pages 47-48.

4.00 DEFENSIVE STRATEGIES AFTER A TAKEOVER BID IS MADE

A number of defensive strategies mentioned under 3.00 may also be available even in the face of a takeover bid.

4.01 Urging Shareholders Not to Accept the Offer/Issue "Don't Sell" Notice/ Director's Recommendation

The most obvious first defence is for the Directors of the target company to reject the takeover offer.(185B) Any response should be forceful and in a way that shareholders of the target company believe the Directors are acting in the shareholders interest rather than self-interest,(186) remembering that generally all companies are for sale at a price and unsolicited takeover bids are never welcome to Boards of Directors but always to shareholders.(186A)

(185B) The initial reponse can be "Guns Blazing" or "Stonewalling" (both expressions are self-explanatory) - S. Higgs, W. Chant, and R. Halstead supra n.27C pages 10-12.

(186) S. Lofthouse supra n.28 page 43-44. Y.F. Danziger supra n.174 page 8.

(186A) S. Higgs, W. Chant, and R. Walstead supra n.27C page 11.

A response seeking to maintain the status quo is for the Directors of the target company to issue a "don't sell" notice, this may in fact be done once a takeover bid is rumoured.(187) The Directors of the target company will urge shareholders to resist the offer, usually adding that further important information will be forthcoming.(188) Key shareholders may be approached, the target company must realise that different types of shareholders are capable of being influenced in different ways.(188A)

The Directors of the target company do not have to make a recommendation in relation to a bid made by a raider.(188B)

(187) This pre-emptive "don't sell" notice was issued by Cable-Price Downer Limited when takeover rumours were circulating (The Dominion 6/5/85).

(188) Y.F. Danziger supra n.174 page 3.

(188A) S. Higgs, W. Chant and R. Halstead supra n.27C page 6. For example institutional investors will be mainly interested in the opportunity cost (if any) of not accepting a takeover bid. Hence the greater the premium the bid is over the prebid market price, the greater the potential opportunity cost, and the more inclined they will be to accept the bid.

(188B) See for background information on recommendations by Directors of target companies.

Y.F. Danziger "The Right of Target Companies' Directors to Stay Silent Upon a Bid" (1985) 5 The Company Lawyer No. 5 page 213 (UK).
M. Agius "Corporate Attack and Defence" (1984) 190 The Accountant 415 page 420 (UK).

4.02 Criticise the Offer:

The takeover offer may be criticised on one or more of the following grounds:

(i) the offer is inadequate(189) particularly if for control of the target(190);
(ii) the offer values the target's shares at less than book-value(191);
(iii) the offer is less than the recent market price of the target company's shares(192);
(iv) the offer lacks commercial logic(193);

(189) S. Lofthouse supra n.28 page 43. If a share exchange is offered it may be alleged that such an exchange based on current prices is unrealistic. Y.F. Danziger supra n.174 page 3.

(190) It is common for a share price of 20-30% above the existing share price to be paid for "control" of a company. See N.L. Scheinkestel "Control - How to Regulate an Elusive Concept" supra n.151.

(191) Y.F. Danziger supra n.174 page 3.

(192) Y.F. Danziger supra n.174 page 3.

(193) S. Lofthouse supra n.28 page 47.
Y.F. Danziger supra n.174 page 8.

An offer is worth resisting, even if the takeover seems inevitable, when the premium offered on the current share price is likely to be higher if there is resistance from the target company's Directors.(194)

Criticism of the offer is normally done with reference to a valuation of the company, and the following should be considered in relation to the valuation:

(a) the credibility of the valuer is paramount therefore choose your valuer very carefully;
(b) realise who is most likely to take notice of the valuation;
(c) be aware of the basis of the valuation (assumptions/methodology/analysis);
(d) timing in producing the valuation and any market reaction to the valuation must be anticipated.(194A)

(194) S. Lofthouse supra n.28 page 43.
Author Unknown "Take-Over Defence Tactics (1984) 6 Company Secretary's Review page unknown (hereinafter referred to as "Co.Sec.Review Article") (UK).

(194A) R. Grant supra n.49 pages 2-5.

4.03 Criticise the Raider/Ascertain the Raider's Objective:

The criticism of the raider may include such matters as its general management philosophy,(195) its history of bad labour relations,(196) its poor past performance operating its own business,(197) its inexperience in the type of business activities engaged in by the target company(198), its acting illegally or contrary to the Stock Exchange Code (if listed), or its giving a false impression in relation to its bid.(198A)

You may wish not to immediately criticise the raider or its takeover bid until more information is available on the raider's rationale for the bid. In this regard the target company may encourage early contact between the raider and the target company and their representatives and advisors. It is important that the target company's personnel are experienced in the art of listening and experienced in illiciting information from people while at the same time giving away as little information as possible (if anything).(198B)

(195) Weinberg and Blank supra n.27 paragraph 2463. It was illustrated in the takeover bid by BIL for Emco where it was reported that the Chairman of Emco alleged that BIL planned to dismember Emco (The Evening Post 27/4/85). Y.F. Danziger supra n.174 page 8.

(196) Weinberg and Blank ibid.

(197) Y.F. Danziger supra n.174 pages 3-4 and pages 8-9. Co.Sec.Review Article supra 194 page (?).

(198) Y.F. Danziger supra n.174 pages 3-4 and page 9. This was reportedly raised by Kiwifruit Industries Limited in commenting on a takeover bid for 51% of the share capital of that company by Charter Corporation Limited (The Dominion 9/7/85).

(198A) Y.F. Daniger supra n.174 page 9.

(198B) S. Higgs, W. Chant and R. Halstead supra n.27C page 6.

4.04 Disclosure of New Information

The disclosure of information to the market has already been discussed (199) and it is believed that tactically it is more effective, as a defence against takeovers, to disclose favourable information prior rather than subsequent to a takeover bid having been made.(200) The delay in disclosing the information may cause criticism to be levelled at the Directors of the target company alleging shareholders have been kept in ignorance of the true value of their shares and shareholders selling prior to disclosure may have been unfairly disadvantaged.(201)

(199) See Paragraph 3.20 of this paper.

(200) Weinberg and Blank supra n 27 paragrph 2460.

(201) Weinberg and Blank ibid.

The following Stock Exchange Code requirements in section 6 headed the Takeover Code are relevant to listed companies.

(i) No material information is to be withheld by either the raider or the target company and all material information made available to any one shareholder in his capacity as shareholder, is to be made available to all.[202]

(ii) A false or uninformed must not be allowed to develop by the raidaer or the target cocmpanya in the shares of either.[203]

(iii) The Board of Directors and the shareholders of the target company are to be given sufficient informations to enable them to make an informed investment judgement. The source of the information should be made clear.[204]

(iv) If the Directors of the target company, having considered all relevant effects including the present price of the company's shares on the market, its past record and its immediate prospects, is in any doubt as to the best interests, of the shareholders, it is recommended that it take independent investment advice. If outside advice is taken, shareholders should be advised of its source and substance.[205]

(202) Paragraph 604 of the Stock Exchange Code.
(203) Paragraph 605 of the Stock Exchange Code
(204) Paragraph 607 of the Stock Exchange Code
(205) Paragraph 608 of the Stock Exchange Code

(v) The Directors of the target company is not to take action to thwart an offer unless they honestly believe that acceptance is not in the best interests of shareholders. If the Directors considers the offer too low, or reasonably believes a higher offer is in prospect, it should so advise shareholders. The seeking of a higher offer is to be confirmed to one reasonably in prospect and is not to be unduly prolonged or used purely as a device to thwart or delay an unwelcome bid.(206)

The new information may relate to the following(207):

(a) revaluation of assets;

(b) forcast of profits;

(c) disclosing new developments are underway;

(d) forcast of dividends or increase in dividend;

(e) share price.

It is a standard defence policy for the Directors of the target company to get an up-to-date property valuation and show that the net assets are worth substantially more than has been reported previously.(208) This strategy may raise two possible problems for the Directors of the target company, (i) a higher asset value may mean a lower return is being earned on the assets than previously thought(209) and (ii) the Directors may find it difficult to not recommend agreement with a revised offer by a raider in line with the asset revaluation (210). Valuation figures may be open to dispute because of the different methods of carrying out a valuation.(211)

(206) Paragraph 609 of the Stock Exchange Code

(207) M. Agius supra n.188 page 7. Co. Sec Review Article n.194.

(208) S. Lofthouse supra n.28 page 46. See also R. Grant supra n.49.

(209) Ibid Y.F. Danziger supra n.174 page 9.

(210) Weinberg and Blank supra n.27 paragraph 2462.

(211) S. Lofthouse supra n.28 page 46. See Z.P. Matolcsy "The Evaluation of Independent Expert's Advice on Takeover Offers : An Economics-Finance Perspective" (1981-82)10 Australian Business Law Review page 99.

An increased profit forecast (better than the market expects or the raider implies) or good comparitive profit forecast with companies in similar industries to target company may be a very useful defence strategy (providing changed accounting policies are not the cause) in showing how well the target company is performing under the present management and indicating future envisaged benefits for shareholders.(212) Profit forecasts also may be disputed.(213)

New developments may be announced for the target company. Such developments may include new orders received, new markets achieved, new products developed, management changes, and the sale or purchase of assets.

(212) Co. Sec Review Article n.194. Y.F. Danziger supra n.174 pages 4 & 9. S. Lofthouse supra n.28 page 46. Weinberg and Blank supra n.27 paragraph 2461. See also R. Grant supra n.49.

(213) This has recently occured during the takeover bid by Adelaide Steamship Co. Limited ("Adelaide") of Wormald International Limited ("Wormald"), in Australia. Adelaide queries various profit projections given by Wormald and its advisors. See The Dominion 13/6/85 headed "Wormald defends profit projection" and The Australian 12/6/85 (Tim Allerton) headed "Wormald attacks Adsteam over letter to holders."

A dispute as to profit projections also occured when it seems a profit projection was made by the Directors of Sovereign Gold Mines Limited (In Receivership) in response to a takeover offer by Westside Traders Limited - The Dominion 3/8/85.

Disclosure of the new information may be carried out by letters or advertisements addressed to the shareholders of the target company; press statements or interviews; "official" profit forecasts and advertisements.[214]

The matters of dividends[215] and share price have been discussed previously in this paper.[216]

(214) Y.F. Danziger supra n. page 4. Co. Sec. Review Article n.194 page . M. Agius supra n.188 page 420.

"... many shareholders pay more attention to the advice they receive from the press and so both sides tend to take the greatest possible care to lobby the press with a view to achieving its support for their case. Advertisements are also widely used."

(215) Co. Sec. Review Article 194 page states:

"The main idea of a dividend forecast is to offer support for the share price should a bid fail."

(216) See paragraph 3.20 (Increase the Share Price) and paragraph 3.100 (Raise the Dividend).

4.05 Bid for Raider ("Pac-Man")

This strategy is named after the popular video game where the target company turns about and makes a takeover bid for the raider.(216A)

In New Zealand the most notable use of this strategy was by NZFP in 1983/84 against Wattie/Goodman after those companies made a partial takeover of NZFP(217)

For this strategy to be viable the target company must have:

(i) Access to the funds needed to finance the counter bid.

(ii) Resolute management determined that the target company must remain independant.(218)

(216A) TIME 4/3/85 page 35. S. Lofthouse supra n.28 pages 46-47.

(217) See S. McArley "New Zealand Forest Products and Wattie : Implications for New Zealand Securities Law" Research paper for the Law of Bodies Corporate and Unincorporate LL.M. (Laws 523) Victoria University of Wellington 1984.

(218) A. Sloan supra n.134.
See also S. McArley ibid in his discussion of the strategy that had to be undertaken by Goodmans to ensure Watties remain independant subsequent to the bid by NZFP.

4.06 Share Dealing

(a) Purchase target company's shares by its Directors or third parties:

The target company can not purchase its own shares[219] however the Directors of the target company or "friendly" third parties may undertake the purchase of shares in the target company.[220]

It is hoped that the purchase of the target company's shares will reduce the number of "free" shares available to the raider and tend to push up the share price.[221]

The Directors of the target company, if listed, must ensure a false or uniformed market does not develop.[222]

(219) Section 62 of the Companies Act 1955. See also T. van Zijl supra n.180.

(220) Y.F. Danziger supra n.174 page 5. S. Lofthouse supra n.28 page 49. Weinstein and Blank supra n.27 paragraph 2456. "Friendly" third parties might include the target company's merchant bank buying shares for various funds it may manage.

(221) Y.F. Danziger supra n.174 page 5. S. Lofthouse supra n.28 page 49.

(222) Paragraph 605 of the Stock Exchange Code. See also paragraph 509 of the Stock Exchange Code which requires a listed company to notify the Exchange if buying or selling a beneficial interest in 5% or more of the issued shares of another listed company.

If, after becoming aware of a possible takeover offer, the Directors of a listed target company wish to deal in any of either shares of the target company or the raider for themselves they must first notify the Stock Exchange. The Directors must also disclose immediately to the Stock Exchange that they have dealt in such shares and disclose the details of volume and price.(223)

The effectiveness of this strategy depends on the ability of the Directors of the target company or "friendly" third parties to purchase sufficient shares to materially effect a takeover bid.(224)

(223) Paragraph 603 of the Stock Exchange Code. The information may be published by the Stock Exchange.

(224) Y.F. Danziger supras n.174 page 11.

(b) Purchase/sell raider's shares by the target company or its Directors:

The target company may encourage friendly third parties to buy the raider's shares to create an opportunity for those shareholders to bring a derivative action against the raider in order to restrain its actions.(225)

If the bid by the raider is on a share exchange basis the target company or friendly third parties(226) may sell shares of the raider in an attempt to depress the share price of the raider so that the terms of the share exchange are less attractive to shareholders of the target company.(227)

(225) Y.F. Danziger supra n.174 pages 5 and 11. See also Weinberg & Blank supra n.27 paragraph 2480.

(226) For example, the target company's merchant bank selling shares of the raider held by various funds under their control.

(227) S. Lofthouse supra n.28 page 49. Y.F. Danziger supra n.174 pages 5 and 11.

4.07 Appeal to The Courts:

In the United States, the target company often issue court proceedings in the Courts on the grounds of possible breaches of U.S. securities or anti-trust legislation, or possible improper conduct by the raider.(228)

In New Zealand and the United Kingdom such a strategy is rarely taken, presumably because of the difficulties the target company or its directors have in establishing grounds for a cause of action.(229)

The writer believes that litigation in the Courts by a target is likely to increase because of the following factors:

(i) the New Zealand Court of Appeal has taken a less restrictive interpretation for the standing required for a party to initiate court proceedings.(230)

(228) S. Lofthouse supra n.28 page 45. Weinberg and Blank supra n.27 paragraph 2479, a Fried Frank Memorandum supra n.69 and Sullilvan and Cromwell, supra n.27D.

(229) Weinberg and Blank supra n.27 paragraph 2480 C.W. Forbes supra n.24 page 72.

(230) Finnigan & Recordon v. N.Z. Rugby Football Union (Inc.) (CA 66/85). This case is already being seen as a guiding decision by the Commerce Commission in the case Bulk Gas Users Group, the Secretary of Energy and The Auckland Gas Company Limited Decision No. 136, pages 6-7.

(ii) an increasing awareness as to possible causes of action including:

(a) attempting to enforce legislative requirements or being a party to proceedings under legislative requirements (eg the Commerce Act 1975)[231];

(b) issuing proceedings based on an allegation that the raider or parties associated to the raider have utilised (confidential) information (especially if the raider has appointed a Director to the target company) belonging to the target company.[232]

(231) See paragraph 4.08 of this paper. The writer believes in the near future the strategy of a United States target company in issuing proceeding for possible breaches of securities or anti-trust legislation will be more available in New Zealand if the personal view of the Chairman of the Securities Commission (C.I. Patterson) is adopted in the New Zealand legislation to require that "pauses and publicity are desirable features in the takeover process to induce ... competition" (Address by Mr C.I. Patterson to the Seminar on Mergers and Takeovers 29th August 1985 n.3 page 25). There will be probability of a new Commerce Act and see also chapter 7 "Proposals for a New Takeover Law in New Zealand" of the Securities Commission Report supra 6.

(232) The U.K. example of the offer by Johnson & Firth Brown for the capital of Dunford and Elliot - Weinberg and Blank supra n.27 paragraph 2480, however such an allegation viewed sceptically by Heron J. in Trounce & another v. N.C.F. Kaiapoi Limited supra n.26.

(iii) a recognition that litigation can be very effective as a defence strategy in certain circumstances, particularly when obtaining an injunction to restrain a raider, and litigation illustrates that the target company's Board of Directors will pursue every avenue to prevent a takeover bid.(233)

A target company should not ignore the fact that the raider may also use Court litigation.(234)

(233) Y.F. Danziger supra n.174 page 10 queried why target companies do not utilise court litigation more often. S. Higgs, W. Chant and R. Halstead supra n.27C page 5 note an escalation in use of litigation in Australia, in particular litigation against directors and see such litigation as an influence on those involved in the takeover battle. (See the report of legal action against Alliance Holdings [an Australian company] and its directors by FAI Insurances - The Dominion 24/9/85 page 14.) This perception of litigation as playing an important role in indicating to the raider the resolve of the target company is also confirmed in the US context in the article by M. Billard "Self-Defence" (1985) The American Lawyer page 110 which discusses the use of litigation in the takeover bid by Mesa Petroleum for Unocal (page 11).

(234) See Baigent & Others v. D. McL. Wallace Limited & Others supra n.26, and Trounce and Another v. N.C.F. Kaiapoi Limited supra n.26 where Heron J. granted interim injunctions:

(i) prohibiting Kaiapoi and the directors (other than Stevens Group directors) of Kaiapoi from acting pursuant to a resolution which formed a committee of directors, to consider, a takeover bid by Stevens Group consisting of all directors of Kaiapoi other than such directors appointed by Stevens Group. The Commitee was to have full power to bind Kaiapoi.

(ii) prohibiting Kaiapoi and the directors (other than Stevens Group directors) preventing the Stevens directors from exercising their rights as directors from exercising their rights as directors of Kaiapoi in relation to the takeover.

4.08 Intervention by the Commerce Commission:

The Commerce Commission's main purpose under the Commerce Act 1975 is to regulate the markets for, and dealings in, goods and services other than securities. Part III of the Commerce Act 1975 establishes a takeover review procedure which is confined to monopoly and competition (antitrust) considerations.(235)

The proceedings of the Commerce Commission and the Examiner of Trade Practices under Part III of the Commerce Act 1975 may allow the target company to participate in the proceedings of the Commerce Commission.(236)

(235) See paragraph 2.32 of this paper.

(236) The administrative law rules in relation to natural justice, the writer believes, may allow the target company to issue proceedings in the Court alleging that the target company has been wrongly excluded from the proceedings of the Commerce Commission or the Examiner of Trade Practices.

See J. Collinge "Merger and Takeover Policy and Procedures in New Zealand" supra n.12 and M. Hill "The Evolution of New Zealand Merger Control and its Administration by the Office of the Examiner of Commercial Practices" supra n.12 for a general discussion on procedures.

The target company may be able to obtain a Commerce Commission decision, or "draft decision"[237] favourable to its defence stragety[238] or utilise or seek to be utilised other provisions of the Commerce Act 1975.[239]

(237) See for a discussion of Commercial Commission "draft decisions" the paper by J. Collinge "Merger and Takeover Policy in New Zealand" supra n.12 pages 7 to 8.

(238) The writer believes this occured such that Cory Wright Salmon Limited withdrew their application for the consent of the Commerce Commission to take over Tolley Industries subsequent to an unfavourable "draft decision" or "preliminary view" to the takeover having been given by the Commission (CSW/Tolley (1984) 4 NZAR 361) and J. Collinge "Towards a Competition Policy in New Zealand" supra n.12 page 26) and S. Lofthouse "Competition Policies as Takeover Defences" (1984) Journal of Business Law 320 (UK).

(239) For example:

(i) Section 81H: The Commission may restrain proposed transactions on the application of the Examiner or any other person with a substantial interest in certain limited circumstances.

(ii) Section 73A: Investigation of merger or takeover not coming with the Third Schedule of the Commerce Act 1975 by the Examiner at the direction of the Commission.

The writer believes that a target company will be able to use the Commerce Act as a defence strategy in a growing number of circumstances in the future for the following reasons:

(i) a more liberal interpretation for the standing required for a party to be part of proceeding.(239A)

(ii) the proposed replacement of the Commerce Act 1975 with the new Commerce Bill 1985. The Commerce Bill 1985 changes the competition test for mergers and takeovers from "effective competition" to a "substantial lessening of competition"(239B) and introduces law relating to restrictive trade practices.(239C) Both changes will allow challenges to be made while the Commission and/or the Courts establish guideline interpretations of the changes.(240)

(239A) Finnigan & Recordan v. N.Z. Rugby Football Union (Inc.) supra n.230 and Bulk Gas Users Group, the Secretary of Energy and the Auckland Gas Company Limited supra n.230.

(239B) Section 66(3) of the Commerce Bill 1985. See also a paper by Donald G. Kempf,Jr "Antitrust Aspects of Mergers and Acquisitions : Course Materials" for the American Management Association Course in Mergers and Acquisitions.

(239C) Part II of the Commerce Bill 1985. The Australian Trade Practices Commission has stated to scrutinise takeovers under legislation similar to the proposed N.Z. legislation - Australian Trade Practices Reporter No. 260 22 August 1985 pages 5 and 6.

(240) See N. Sallee "Landmark decisions expected with Commerce Law" National Business Review 17.6.85.

4.09 Intervention by The Securities Commission:

The Securities Commission has the power to investigate in depth and comment on a particular company takeover and such power may be exercised while the takeover attempt is in progress.(241)

However, while the Securities Commission has investigated various takeovers such investigations are normally after the takeover had been completed(242) and the Securities Commission has only a power to publish a report or make recommendations to the Minister of Justice.(243)

(241) Section 10 of the Securities Act 1978, the case of City Realties Limited v. The Securities Commission supra n.15C.

(242) The latest being an inquiry into dealings in shares of Emco Group Limited (Securities Commission Terms of Reference dated 25th July 1985). For press reports of the inquiry see The Dominion 16/8/85 (page 12) and 17/8/85 (page 17) and The Evening Post 17/8/85 (page 14).

(243) Sections 10 and 28A of the Securities Act 1978. The writer gives a limited interpretation to Section 17 of the Securities Act 1978, agreeing with view expressed in Darvell and Clarke Securities Law in New Zealand supra 15 paragraph 3.16.

A report, although only with recommendations, can have a substantial effect on company's or person's reputation and business standing.

The Securities Act 1981 and possible intervention by the Securities Commission would be relevant if a takeover offer was made by "standing in the market" by a raider and involved a share swap. It may be argued in such circumstances that a prospectus is required to be issued.(244)

The writer believes that the Securities Act 1981 will be of greater importance to defence strategies if the legislation is amended to adopt the personal view of the Chairman of the Securities Commission by requiring "pauses and publicity ... in the takeover process ..." (245)

(244) See n.15A and n.15B for references.

(245) Address by Mr C.I. Patterson to the Seminar on Mergers and Takeovers 29 August 1985 n.3 page 25.
See also Chapter 7 "Proposals for a New Takeover Law in New Zealand" the Securities Commission Report supra n.6.

4.10 Threaten Management Resignation ("The Neutron Bomb" defence):

The "Neutron Bomb" defence strategy is that the structure of the target company will be there, but the people will be gone.(254A)

The threat of management resignation will be most powerful in companies where a few key individuals are disproportionately important, especially if there is a chance that such management will set up directly competitive enterprises.(246)

4.11 Urging the Raider's Shareholders to Oppose their Board's Takeover Bid for the Target Company:

This strategy is used only very rarely.(247)

The Directors of the target company may argue the following:

(i) alleged breach of fiduciary duties or duties of care and skill by the Directors of the raider;

(ii) the lack of experience or ability by the raider in managing the business of the target; or

(iii) that the takeover expenses and funds raised will be a heavy burden on the raider.(248)

The Directors of the target company should be careful not to argue that the target company is not a worthy target, since the Directors of the target company will later face difficulties in convincing the target company's shareholders not to accept the raider's offer.(249)

(246A) A. Vrisakis and G. Samuel supra n.33 page 11.
(246) S. Lofthouse supra n.28 page 49. Y.F. Danziger supra n.1 74 page 12.
(247) Y.F. Danziger supra n.174 page 13.
(248) Y.F. Danziger ibid.
(249) Y.F. Danziger ibid.

4.12 "Standstill" Agreements:

A "standstill" agreement is typically entered into by a target company and a raider. The raider agrees to cease (at a standstill) its acquisition of shares in the target company, typically for a defined period unless further acquisitions are approved by the target company's management.(250)

Such agreements may give the management of the target company a long-term "friendly party".(251)

A person or company, whether a raider or not, agreeing to execute such an agreement in relation to its purchase of a target company's shares may, in return, be given access to confidential information from the target company.(252)

(250) The most publically known "standstill" agreement is the Wattie/Goodman/NZFP agreements, somewhat more complicated than merely between target company and raider, and described in paragraph 3.50 of this paper.

Such agreements are commonly used in the U.S., especially after a target company has purchased its own shares from a raider, and as a condition of the purchase of its own shares the target company requires the raider to side a "standstill" agreement. However in New Zealand presently a company can not purchase or assist in the purchase of its own shares (Section 62 of the Companies Act 1955 and T. Van Ziji supra n.180).

(251) J.C. Coffee Jr. supra n.72 page 1262 (footnote 353). Such "standstill" agreement partner may not always remain "friendly" see the case of Enterra Corporation v. SGS Associates E.D. Pa. Jan 9 1985 (U.S.) where the Court found valid corporate purposes for "standstill" agreement (one partner to such an agreement was seeking to avoid its contractual obligations). Information from Fried Frank Memorandum supra n.69.

(252) J.C. Coffee ibid page 1261.

There is the recommendation in the U.S. that if such "standstill" agreement is to be effective for greater than one year then the shareholders of the target company should be required to approve the target company entering into such agreement.(252A)

(252A) J.C. Coffee ibid page 1262.

See also Recommendation 37 of the U.S. Securities and Exchange Commission Advisory Committee Report on Tender Offers July 8 1983 (page 38).

4.13 Use Business, Social and Political Relationships:

This paper has discussed the importance of a target company selecting top advisors.[253]

Further lobbying may be envisaged of the following:

(a) The target Company's Brokers:
The brokers may help reinforce shareholders' loyalty by keeping them generally informed of the target company's progress.[254]

(b) The target company's customers, suppliers & distributors:
Illiciting a statement by the target company's customers, suppliers and/or distributors that the relationship(s) with the target company might be terminated if the present management of the target company is removed may have a chilling influence on a raider.[255]

(253) See paragraph 316 of this paper.

(254) Y.F. Danziger supra n.174 page 13.

(255) Y.F. Danziger ibid page 12.
S. Lofthouse supra n.28 page 49.

(c) The target company's labour force and unions:

The support of the target company's labour force and unions, particularly if redundancies or rationalisation seems likely by the raider, can be very useful to a target company in attempting to thwart a takeover bid.(256) This approach can be more effective if the target company can refer to specific examples where the raider has taken over a company and redundancies or "dismemberment" has occured.(257)

The influence of the company's labour force may be magnified when a target company is under a takeover bid if the target company has issued a significant shareholding to the target company's labour force or the target company's labour force superannuation scheme.(258)

(d) Institutional Shareholders:

Institutional shareholders of the target company, who may have less loyalty to the target company itself, will normally be very conscious of and affected by the views of the management and the labour force of the target company to a takeover bid by a raider.(259) Forceful lobbying by management and the labour force may influence the attitude of institutional shareholders to a takeover bid.(260)

(256) Y.F. Danziger supra n.174 page 12. S. Lofthouse supra n.28 page 49.

(257) Weinberg & Blank supra n.27 paragraph 2476.

(258) See paragraph 3.70 of this paper on the issue of shares to "friendly" third parties.

(259) Weinberg and Blank supra n.27 paragraph 2476.

(260) Weinberg and Blank ibid.

(e) Political lobbying at national, regional or local level: Nationalism or patriotic sentiments may be called upon if the raider is "foreign", such sentiments may be aimed at shareholders[261] and governmental bodies if government consent is needed for the takeover.[262] Also regional or local interests may be relevant, particularly if there is a significant regional or local shareholding and the takeover may affect regional or local employment or development.[263]

(261) This is illustrated in the possible bid by Elders-IXL Limited (Australian) for Allied-Lyons PLC (British) when the chairman of Allied-Lyons PLC in discussing the possible bid stated:

> "... We are supposed to live with that for up to six weeks while this Australian company makes up its mind." (The Dominion 7/9/85 page 13).

See also The Evening Post 7/9/85 page 13 article on the matter headed "Ambitious Elders 'cheeky, un-British'".

(262) This was illustrated in the proposed takeover by ACI (Australia) of AHI (New Zealand). The writer understands ACI's bid was turned down by the N.Z. Minister of Finance after strong lobbying by New Zealand interests. Y.F. Danziger supra n.174 pages 12-13. S. Lofthouse supra n.28 page 49. Weinberg & Blank supra n.27 paragraphs 2477 and 2478.

(263) Y.F. Danziger supra n.174 pages 12-13.
S. Lofthouse supra n.28 page 49.

(f) Individual shareholders:

The "loyalty" for "their company" may be illicited from small individual shareholders especially if such shareholders have held their shares for a long time.(264) The shareholders may attach importance to the name of "their" company and the independance of its business.(265)

5.00 CONCLUSION

Although defence strategies against takeovers will vary in accordance with the circumstances of each target company, and according to the identify of the likely raider, the writer believes certain practical steps are available to all companies in order to make that company less likely to incur an uninvited significant change of ownership.

A company must be aware that:

(i) "IT" may be a target company and recognise why it would be a target company for a possible raider.

(ii) It should have developed some long term objectives for the company (ie where the company sees its position in its particular industry), planned how it intends to achieve such objectives and communicated such objectives to its shareholders.

(264) Weinberg & Blank supra n.27 paragraph 2476. See footnote 62 of Weinberg & Blank ibid for example.

(265) Weinberg & Blank supra n.27 paragraph 2476.

Any defence strategies should have as their initial basis the following:

(a) Be prepared. Don't wait to recieve a takeover bid before contemplating defence strategies.

(b) Don't panic. Don't take a "knee-jerk" reaction to the possibility or eventuality of a takeover bid as it may be regretted later.

(c) Don't ignore the "key" players in a takeover situation - the target company's shareholders. Factual, comprehensive and planned information should be made available to a target company's shareholders on a continual basis. The shareholders must be motivated so acceptance of a takeover bid is seen by the shareholders not to be in their own best interest.

If a takeover bid is received the Board of Directors of the target company must:

(1) Give guidance to the shareholders of the takeover company by making a response in a forceful manner and in a manner that encourages the shareholders of the target company to believe the Directors are acting in the shareholders' interest rather than their own self interest.

(2) Recognise their fudiciary duties to the target company and its shareholders.

(3) Have a clear perception as to the company's position in a takeover situation.

(4) Clearly and unequivocably communicate their attitute to the bid to the raider taking cognizance of all the remedies available (including court litigation).

Fighting a takeover is like fighting a war and persistance and pugnacity is essential to a successful takeover defence strategy.

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